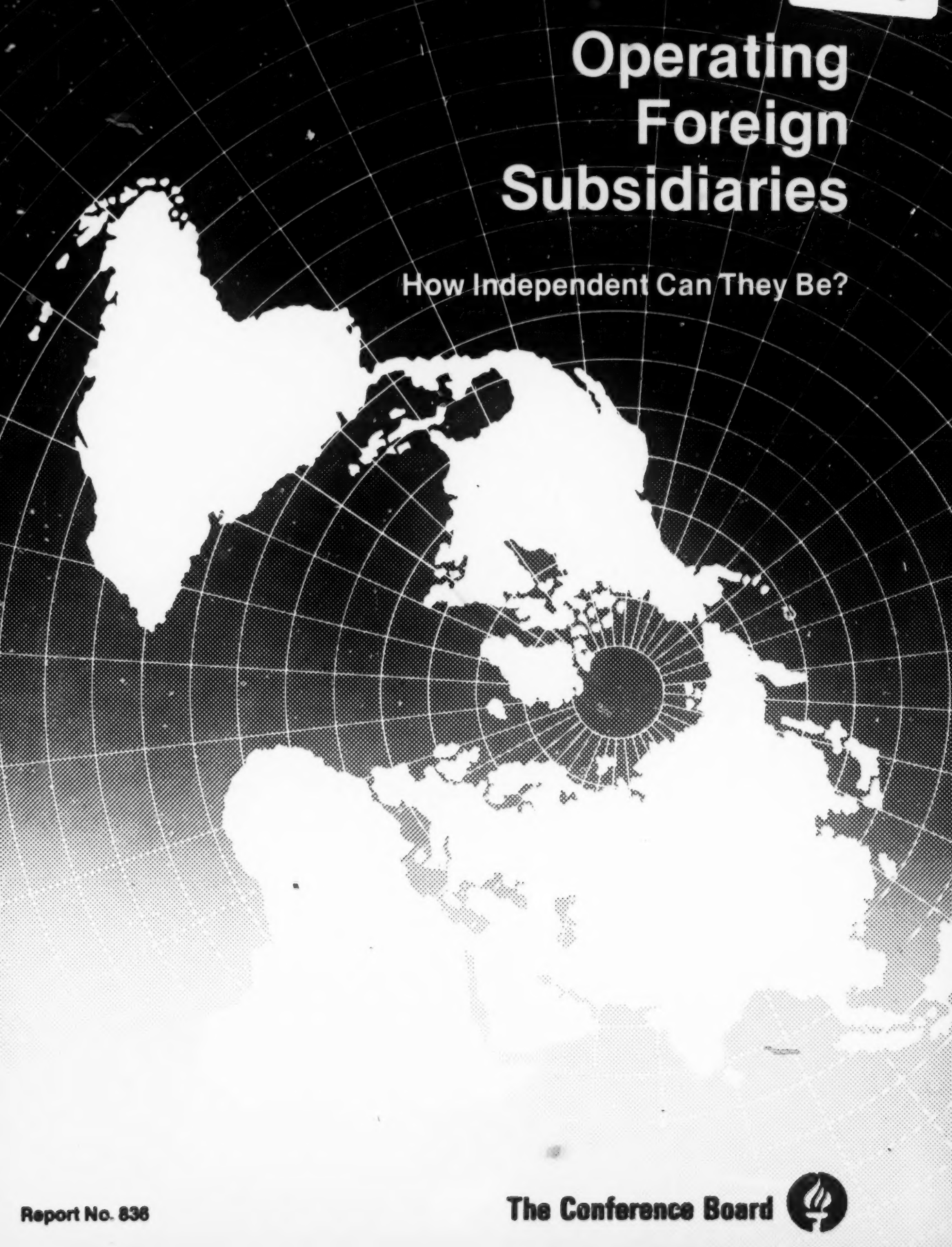


Operating Foreign Subsidiaries

How Independent Can They Be?



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Operating Foreign Subsidiaries: How Independent Can They Be?

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A Research Report from The Conference Board

Contents

	<i>Page</i>
HIGHLIGHTS	vi
WHY THIS REPORT	ix
1. PARENT-SUBSIDIARY RELATIONS: AN OVERVIEW	1
Parent Companies and Their Foreign Subsidiaries:	
Choosing Between Flexibility and Oversight	1
The Companies	2
The Decisions	2
The Local Demands	3
General Findings	3
Variations in Decision-Making Pattern by Company Type.	4
General Delegation of Authority to Managers of Local Units	5
The Pressure of Local Demands	6
2. DECISION MAKING IN LOCAL SUBSIDIARIES	7
Decision Making: Some Basic Principles	7
Decision Making: The Pattern	8
3. LOCAL CONDITIONS AND DECISION MAKING	13
Countries that Make Demands: Some Important Characteristics	14
Effects of Demands on Companies	16
Special Problems with Local Demands: Financial Participation	17
Special Problems with Local Demands: Research Facilities	19
Efforts by Local Governments and Labor Unions to	
Participate in Decision Making	21
4. DECISION MAKING AND LOCAL FINANCIAL CONTROL IN	
PERSPECTIVE	25
Impact of Local Control on Decision Making	25
Partnership with Local Governments	25
Contrasts in Decision Making and Impact on Local Control in	
Different Companies	26
Company Organization	26
Economic Configuration	28
The Nature of the Local Enterprise	28
Capital- and Labor-Intensive Companies	28
Percentage of Foreign Business	28

5. DELEGATION OF AUTHORITY TO LOCAL MANAGERS OF FOREIGN SUBSIDIARIES	30
Important Considerations in Delegation of Authority	32
Proprietary and Cultural Issues	32
Delegation of Authority by Country	33
APPENDIX	35
Local Demands: Which Countries	36
Countries to Watch	36
Countries of Special Interest	36
Regional Characteristics	38

Tables

1: Relationship Between Local Demands and Company Decisions	8
2: Changes During the Last 10 Years in the Local Managers' Authority for Key Decisions	9
3: Decision Making Authority of Heads of Local Units	11
4: Pattern of Decision Making by Company	12
5: Effects of Local Demands on Corporate Decision Making	17
6: Frequency of Local Demands and Expectations as to Future Occurrences	18
7: Company Response to Local Demands	19
8: Impact of Local Demands	20
9: Demands by Local Governments and Unions for Participation in Company Decision Making	23
10: Need for Parental Approval for Various Local Decisions and Actions	26
11: General Delegation of Authority and Delegation When Local Interests Control—10 Key Decisions or Actions	27
12: Factors Resulting in a High Degree of Decision-Making Authority for Local Managers	31
13: Degree of Autonomy of Local Managers in Foreign Countries	33

Appendix Tables

A-1: Countries That Make Frequent Local Demands	37
A-2: Countries in Which Demands Are Expected to Become More Frequent in the Next 10 Years	37

Charts

1: Degree of, and Change in, Local Managers' Authority for Key Decisions	10
2: Prevalence of Local Demands by Industrial Level and Anticipated Market Growth	15

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In addition, executives from around the world who were present at the 1981 International Industrial Conference in San Francisco expressed provocative views on many of the issues addressed here.

As in the past, Lillian W. Kay, Manager, Editorial Services, provided valuable editorial support in clarifying this material and ensuring that it is accessible to the reader.

Highlights

CORPORATE MANAGEMENT of branches, divisions or subsidiaries in foreign countries is subject to many of the fundamental considerations of management in a more general context. The company must distinguish the local business decisions and actions that profit from flexibility and initiative for the local manager from the business actions that require firmer corporate oversight or control. This is never an easy decision, and when it is complicated by local demands that seek to influence the decision-making process, the choice between flexibility and oversight becomes more complicated.

The basic pattern of decision making allocates considerable independent authority to foreign units for business decisions and labor and external relations, as Chapter 2 documents. In the early 1970's, local freedom for these activities was already considerable; in the last ten years many companies have given their local managers even more discretion for handling these issues.

Large capital expenditures are another matter. Companies have not been liberal in their charters for this purpose, and, in the last decade, some have even withdrawn a portion of the limited authority that they gave to local managers in earlier years.

Of course, the degree of authority delegated to the local manager varies considerably from unit to unit and from person to person. Chapter 5 focuses on the weight given to these various factors by participating companies. It is evident that unit size, success and company confidence in the local manager play important roles.

External interference with company decision making is treated in Chapter 3 and the Appendix. These episodes are prevalent in relatively few countries—most of which are currently profitable—and expected by the respondents to be increasingly so in the next decade. The demands have had a measureable impact on company decision making, but only a few companies have decided not to do business within the country because of them.

Other factors besides the subject matter of the decision, the size and reputation of the local unit, and external pressures influence the degree of authority a local manager will have for a particular decision. When

local financial interests control a majority of the stock, an appreciable number of companies are less likely to require their approval. Chapter 4 discusses the effects of local control in some detail. Not all companies react to local financial control in the same way, and marked differences were noted in the response pattern when companies were grouped according to organization, economic configuration of the firm, type of products (technological or consumer), nature of the business, and percentage of foreign sales.

Method and Sample

In conducting this research, The Conference Board started by interviewing a small group of high-level, experienced U.S. and European executives. In these conversations, and others in earlier projects, they were asked to isolate the key decisions that define the relationship between the parent company and its foreign operational centers. In addition, questions were raised about the particular local demands that have proven to be the most vexing in recent years in their company's efforts to manage and coordinate a worldwide enterprise. The patterns of authority within their companies and the factors—personal, business and environmental that contributed to a substantial delegation of authority to local managers or the subsidiaries they headed—were also discussed.

These views were used to develop a questionnaire that was designed to examine the patterns of authority for local decision making, the nature of local demands and where they were present to the most substantial degree, general factors in delegation of authority, and changes in company practices and problems over the last ten years.

After the questionnaire was developed and mailed to U.S., Canadian and European companies with at least 20 percent in foreign sales and one operating subsidiary outside the home country, high-level executives of a representative sample of major U.S. and European multinational firms were interviewed.

The 109 U.S., Canadian and European companies that responded to the survey bring a considerable degree of experience to this endeavor. In 1981, the median company in this sample had nearly \$2 billion in sales—40 percent of which was in foreign countries. The median company maintained 20 branches, divisions or subsidiaries in foreign countries. Seventy-nine companies reported that they had at least one subsidiary in which local shareholders had a controlling interest, and thirty-seven are in partnership with the government in at least one country in which they do business.

They represent not only an experienced, but a generally

optimistic, segment of the international business community: The majority expect that, within the next ten years, foreign sales as a percentage of their total revenues will either be somewhat or significantly greater.

High-level executives involved in international business activities with companies that operate on this scale and scope will be interested in the problems and the observations of individuals in similar companies. But those with important international responsibilities in smaller firms that are considering their first foreign venture, or are just beginning to encounter some of these difficulties, will also find this material of interest.

Why This Report

About two years ago, the chief executive of a major European multinational company asked the author of this report: "What do you suppose is the impact of governmental demands on the position of the local subsidiary manager?" While the question was asked rhetorically, the concern was real. Although the requirement for local financial participation is the most familiar of local demands, local conditions affecting management have been growing in number and variety. Such demands are often thought to impair the ability of parent corporations to manage.

How can the parent corporation go about assuring appropriate and responsible management control in the face of local governmental demands? Implicit in the question of this European chief executive was a concern

about the long-term viability of international enterprises. This report focuses on the decision-making authority of managers of foreign subsidiaries in 109 U.S., Canadian and European multinational companies. It examines how the often conflicting needs of the parent corporation, the local unit, and the host country are reconciled in the management process.

For the composite answers, and their implications for successful management of the international parent-subsidiary relationship, we owe thanks to all the executives in U.S., Canadian and European companies who shared their experience and views with us.

JAMES T. MILLS
President

Chapter 1

Parent-Subsidiary Relations: An Overview

THERE ARE TENSIONS inherent in the relations between corporate headquarters and operational profit centers. The tensions arise from the contradictory motives and resulting policies that are viewed as contributing to profitability.

Most companies today choose to describe themselves as "decentralized." The heads of sectors, branches, divisions or subsidiaries are generally encouraged to think of themselves as the heads of independent or autonomous businesses. The benefits that flow from decentralization are believed to be enormous; flexibility, motivation and productivity are all thought to result from granting freedom and initiative to operating units within the company.

There is a second perceived advantage to decentralization. A decentralized corporate structure is seen as providing a company with opportunities for better adaptation to local conditions, and more opportunities to perfect various approaches to production, marketing, sales and servicing.

But there are powerful forces that also pull the company in an opposite direction. The demand for a unified profit-and-loss statement for all the company's many businesses is the most obvious of these centralizing requirements. The enormous commitment of capital resources that is needed for plants, equipment and research facilities necessitates a centralized spending authority to set priorities. A major trend of recent years has been the purchase, rather than the development, of new businesses and this kind of decision is made in corporate headquarters. Government regulation often requires that decisions involving sensitive areas such as personnel and plant location be monitored by the parent company either through well-defined policies or more direct involvement.¹

Close examination of how companies resolve this tension between centralization and decentralization in a variety of situations reveals that companies are continuing to decentralize for the purpose of making certain kinds of decisions even as they centralize their procedures for others. The art of management, from whatever vantage point it is practiced—factory floor, regional center, or corporate body—consists in large measure of distinguishing those kinds of actions where greater flexibility and initiative is required from the decisions that necessitate greater oversight, supervision, coordination and control.

Each company makes these judgments in its own way. The emerging pattern is largely the result of the way the company is organized, the product or products it sells, the wealth of its resources, and, perhaps most importantly, its institutional wisdom—the years of experience that the company has accumulated through trial and error. For business is, after all, a pragmatic endeavor; if something works, it continues to be done for as long as it does; if it fails, it is done differently the next time. Finally, the authority to transact business often rests on personnel considerations, and depends greatly on the trust and understanding that exists between superior and subordinate.

Parent Companies and Their Foreign Subsidiaries: Choosing Between Flexibility and Oversight

When these tensions are examined in the context of the relationship between a parent corporation and its *foreign* subsidiaries, the difficulties of distinguishing the decisions that profit from flexibility and initiative from those that require oversight and supervision become even more complex. Even more than their domestic colleagues, heads of foreign subsidiaries are in charge of companies with their own identities. The units they head often have independent legal status and their own boards of directors.

¹Ronald E. Berenbeim, *Regulation: Its Impact on Decision Making*. The Conference Board, Report No. 803, 1981.

These subsidiaries are also subject to the laws of the country in which they operate. The operating heads may have titles such as "president" or "chairman of the board" and they are pro forma chief executives. These "companies" may well be geographically and culturally distant from the parent firm and its operating realities.

In addition, many local governments (and, in some cases, groups of governments such as the Andean Pact nations) have attempted to exercise control or to participate, directly or indirectly, in the decision-making processes of local subsidiaries of foreign corporations. Although governments are the most frequent actors in this regard, other groups such as labor unions, industry associations, and single-interest organizations may also seek involvement.

The motives for these pressures vary widely. In some cases, ideologically motivated governments (both left and right wing) are attempting to extend their control over all aspects of the national life, and this effort includes both domestic and foreign businesses. In other instances, the foreign subsidiaries are singled out for local demands as an expression of nationalistic fervor, or in a strategy to get the company to share the wealth that, in the opinion of local interests, it has accumulated at the expense of the local populace. Finally, in some cases, pressure on local subsidiaries has been used to place local demands before a distant and globally powerful parent corporation.

What is the pattern of decision making and delegation of authority that has emerged from this environment? What are the countries where this problem is particularly acute? How are these issues resolved from one company or one country to another? Has local pressure created more or less local autonomy for foreign subsidiaries? What does this do to the ability of parent corporations to supervise the activities of local subsidiaries and to develop and coordinate a worldwide strategy?

To answer these questions, The Conference Board interviewed a small group of high-level, experienced U.S. and European executives. In these conversations, and others on an earlier project, they were asked to isolate the key decisions that define the relationship between the parent company and its foreign operational centers.² The particular local demands that have proven to be the most vexing in recent years in their companies' efforts to manage and coordinate a worldwide enterprise were also discussed. The conversations also focused on the patterns of authority within their companies and the factors—personal, business and environmental—that contributed to a substantial delegation of authority to local managers or the subsidiaries that they headed. All these views were used to develop a questionnaire that would examine the patterns of authority for local decision making, the

nature of local demands and where they were present to the most substantial degree, general factors in delegation of authority, and changes in company practices and problems over the last ten years.

The Companies

The 109 U.S., Canadian and European companies that participated in this project bring a considerable degree of experience to this endeavor. In 1981, the median company in this sample had nearly \$2 billion in sales—40 percent of which was in foreign countries. The median company maintained 20 branches, divisions or subsidiaries in foreign countries. Seventy-nine companies reported that they had at least one subsidiary in which local shareholders had a controlling interest, and thirty-seven are in partnership with the government in at least one country in which they do business.

They represent not only an experienced but also a generally optimistic segment of the international business community; the majority expect that foreign sales as a percentage of their total revenues will either be somewhat or significantly greater within the next ten years. This outlook is, perhaps, an outgrowth of their experience in the 1970's. During that decade, foreign sales for these companies rose from a median figure of 30 to 40 percent. Nearly half of this sample anticipate significant growth in Latin America, and almost three-quarters expect it for Asia.

The Decisions

The executives interviewed by The Conference Board identified ten key decisions or actions affecting local operations as being especially significant for the purpose of testing decision-making authority and delegation in an international company. One of these was a business decision: the introduction of a new product. Three related to commitments of large amounts of capital: (1) purchase of a new business (or the sale of an existing one), (2) entering into a joint venture, and (3) building a new plant for the local unit. Two were in the labor and external relations area: (1) negotiation of a labor contract, and (2) handling sensitive political issues with a local government. Two were top-level personnel actions: (1) the selection of a new head for the local operating unit, and (2) the choice of a director for the board of the branch or subsidiary. One was a territorial or jurisdictional issue: the decision that the regional or local unit will enter a new country. One decision, the establishment of a research or development laboratory did not fall nearly into any of these categories. These facilities generally entail large capital commitments, but development laboratories, in particular, are part of the product-introduction process. One could even argue that the staffing requirements of these installations also raise personnel and labor issues.

²The earlier project was reported in: Ronald E. Berenbeim, *Managing the International Company: Building a Global Perspective*. The Conference Board, Report No. 814, 1982.

The Local Demands

Nine demands by local governments were named by the participants as having significant impact on international operations or as being especially prevalent. Three of these conditions relate to financial operations:

- (1) a requirement of local financial participation in company ownership,
- (2) a limit on research fees for work performed for local subsidiaries by the company's central laboratories, and
- (3) a limit on repatriation of assets and earnings.

Four entailed interference in company business decisions:

- (1) a requirement that component parts or raw materials be purchased locally,
- (2) a limit on levels of local production,
- (3) a limit on the company's share of the local markets, and
- (4) an insistence that the company produce or sell certain products as a condition of entry into the local market.

One demand involved a personnel issue: the appointment of local nationals to top-management positions.

The requirement that the company build a local research or development facility was seen as being relevant to three managerial concerns: finance, business and personnel.

General Findings

The survey and subsequent interviews with executives in the United States and Europe confirm the view that within the last ten years the size and scope of foreign operations have become larger and more complex. This development has led to a more sophisticated approach in apportioning authority between the parent corporation and its local subsidiaries. Evidence of this can be seen in the evolving charters granted to local managers and in the increasing emphasis on financial controls. There is greater sophistication in the view that authority is divisible. Even as companies are increasing local authority for certain kinds of decisions they are reducing it for others.

The clear trend (though a majority of companies have not changed their local managers' level of authority for the decisions examined) is for greater authority to make business, labor and external relations decisions, and less discretion to commit capital resources. As foreign operations grow in size and complexity, and in their overall importance to the firm, parent companies are feeling a greater need to exercise more careful capital-expenditure controls over their local operations. As a result, the local manager has become something of an

entrepreneur; these managers have considerable independence to make business, labor and external relations decisions, but they must sell their plans to the tight-fisted banker at home.

Company insistence on retaining final authority for capital expenditures is almost universal. When purchasing a local business, entering a joint venture, or building a new plant, roughly 90 percent of the subsidiaries or divisions obtain corporate approval. When local financial interests control the subsidiary, many companies give the local manager greater freedom to pursue the sources and means of financing the company's local activities, but direct corporate oversight, with a requirement of parent-company approval, continues to be the case for over 70 percent of the local units, even in this situation.

Companies also guard their prerogatives to select top personnel and to have the final say as to whether a foreign subsidiary enters a new country. This is true under all circumstances.

With personnel decisions such as the choice of a new operating head, or the selection of a director for the subsidiary's board, a substantial number of companies reduce the level of parental involvement when local interests are in the majority.

This is not the case when the local unit is contemplating doing business in another country. For this kind of decision, the parent company is nearly as likely to require headquarters approval as when the subsidiary is wholly owned.

For business decisions such as product introduction, slightly less than half the foreign units need final corporate approval. The trend is clearly in the direction of more authority for the local manager. Control by local interests has no effect on the degree of authority delegated to the local manager for these kinds of decisions.

Labor contract negotiations and external relations have historically been the province of local managers. Less than 10 percent of the subsidiaries or divisions must secure corporate approval to resolve local labor issues and, in negotiating political issues with local interests, only one-quarter must obtain such approval. A significant number of companies in each case have increased their local managers' authority to deal with problems in these areas during the last ten years. Local financial control has little impact on such decision-making areas, which, in the large majority of cases, are already handled locally.

The decision to establish research or development facilities, as already indicated, is not amenable to neat classification as are capital-expenditure, business or personnel decisions. Nearly 80 percent of the companies insist that wholly owned subsidiaries obtain corporate approval for this decision. In those units with local financial control, the figure is lower, but it is still a solid

majority; roughly 60 percent. A marked number of companies have increased their local managers' authority for dealing with this issue during the last ten years, but an equally marked number have reduced it. Clearly the parent companies are having the same difficulty with classifying this action; is it a capital-expenditure decision—in which case they want more control; or is it a business action—in which instance they are willing to settle for less oversight?

Variations in Decision-Making Pattern by Company Type

Does this decision-making pattern vary in different kinds of companies? Past research suggests that certain categories can be useful in comparing and contrasting company approaches to decision making, delegation and the impact of external forces. In this context it is helpful to ask respondents to indicate which of the following identities best describes their company:

- Is the company organized along geographic or product lines? A geographic company is one in which the profit centers are regional units. A product-line organization groups its profit centers according to a single product or group of products. Participants were also given the option, where appropriate, to describe their organization as being "evenly divided between the two."

- Is the economic configuration of the company seen as a single business; multiple businesses, related; multiple businesses, unrelated; multiple businesses, unrelated (no corporate identity). In this context, these terms are defined as follows:

Single businesses: One company producing a single or homogeneous product for a single, more or less homogeneous, market.

Multiple businesses, related: One company producing a variety of products for a variety of markets, but with a high degree of overlap in markets and distribution for the various products or a high degree of integration in materials or technology involved in manufacturing the products.

Multiple businesses, unrelated: One company producing a variety of products for a variety of markets, but there is no overlap in manufacturing and marketing operations. There is virtually no overlap in the markets served, or in the resources or technology employed in producing the variety of goods or services.

Multiple businesses, unrelated (no corporate identity): One company made up of unrelated businesses, but with little or no attempt to project a single company identity.³

³Harold Stieglitz, "On Concepts of Corporate Structure: Economic Determinants of Organization," *The Conference Board Record*, February, 1974.

This is sometimes referred to as a "true holding company."

- Do Companies characterize the foreign markets for which the bulk of their products are designed as technologically oriented, consumer oriented, or evenly divided between the two?

A word of explanation is in order with regard to these categories. Whether they are manufacturing or service companies, all firms develop, produce and distribute. Depending on the nature of the business, and management's strategy for achieving results, one or another of these three processes often dominates. They are the lead functions or activities. To get at these differences and to clarify their effects on decision making and delegation, the participants were asked for a self-evaluation of their perceptions as to whether the foreign markets for which the company produces a major portion of its goods or services are "technologically" or "consumer" oriented—or evenly divided between the two. As used in the remainder of this report, "technological" and "consumer" companies are those that identified themselves as such.

- Are the company's foreign businesses capital or labor intensive? Or is there an approximately equal mix between the two?

- What percent of the company's total sales in 1981 were outside the home country of the parent corporation? For purposes of analysis, the respondents were then divided into one of three equal groups, based on the company's percentage of foreign sales: 1-33 percent, 34-49 percent, and 50 percent or more.

Analysis of the decision-making pattern for each of these categories reveals the following similarities and differences in approach:

For capital appropriations: The degree of retention of authority by the parent corporation for capital-expenditure decisions is uniformly high for all kinds of companies. However, managers of local subsidiaries of single businesses are less likely to need parental approval to build a new plant.

For top personnel selections: Subsidiaries or branches of geographic organizations and companies that do more than 50 percent of their business in foreign countries are less likely to need parental approval for the choice of a new local manager. Single-product companies and capital-intensive businesses insist with greater frequency on approving the selection of new board members.

For territorial or jurisdictional issues (for example, deciding to do business in a new country): Companies that regard themselves as being evenly divided between product-line and geographic organization are considerably more likely to insist that local subsidiaries obtain final approval from corporate headquarters to enter a new territory than are firms that see themselves as primarily geographic or product-line organizations. In

fact, product-line companies are less likely to retain this prerogative than are their geographic counterparts. Similarly, multiproduct unrelated structures do not require parental approval as often as single product and multiproduct-related structures. Finally, as the percentage of foreign business goes up, the need for approval of this kind of decision increases significantly.

- *New product introductions:* Those companies that are evenly divided between geographic and product-line organizations are much more likely to require their local units to obtain parental approval for a decision than are either of their more homogeneous counterparts. Similarly, those companies that consider themselves to be a combination of capital- and labor-intensive businesses also require parental approval more often for business decisions than do either capital- or labor-intensive companies. Finally, single-product businesses also insist on corporate approval for new-product introductions more often than do multiproduct firms.

- *For labor relations decisions:* Companies of all kinds seldom require corporate approval for these decisions. For product-line, labor-intensive, and companies that do more than 50 percent of their business in foreign countries, final approval of major labor actions are virtually never required.

- *For sensitive local political issues:* The pattern is more varied. Companies that are evenly divided between product-line and geographic organizations are more likely to require parental approval for important decisions than are either geographic or product-line companies. Organizations that do more than 50 percent of their business in foreign countries are also more likely to insist that their subsidiaries obtain final approval than are those firms that are less dependent on foreign earnings. Finally, multiproduct, related companies hardly ever require that actions taken in this regard be submitted to them for final approval.

- *For the establishment of a research or development laboratory:* There is relatively little variation in the decision-making pattern. However, geographic organizations are much more likely to require their subsidiaries to obtain corporate approval than are product-line companies; and capital-intensive businesses much less frequently insist on corporate assent than do labor-intensive firms.

General Delegation of Authority to Managers of Local Units

Local demands for financial control and top-management positions have some impact on the delegation of authority to local managers. But the effect of these conditions is seldom decisive and their importance is weighed within the context of traditional considerations.

Foremost among these are the status and experience of the local manager. Individuals who have high rank, or a lot of experience—either in other countries, or in the parent company's headquarters—tend to have greater authority than those who do not. Managers of large units generally have more latitude for independent decisions than heads of small ones. Finally, where the company has been active in the country for a long time, there are well-established business, cultural or geographic ties between the country of the parent and the region in which the unit is located—or the subsidiary is in an industrially developed country—there is likely to be greater authority for the manager of the subsidiary.

Taken together, the survey findings demonstrate that companies value experienced managers and place them in large, well-established units where they have considerable freedom for independent action and decisions. This does not depart markedly from the domestic pattern for delegation of authority. But in the parent-foreign subsidiary context each of these criteria has additional dimensions.

Managerial experience is important because the individual needs familiarity with the company's overall strategic designs and the ability to respond quickly to local problems. Thus, service in corporate headquarters and in local units in other countries is helpful both to the manager and to the company. High rank is recognition of achievement in these various posts and it also imparts notice to local interests that they are dealing with a person who is important in the firm.

The greater independence of the larger units suggests that they have a strong bargaining position with both their companies and the governments of the countries in which they are located. This makes it more likely that the company will defer to their analysis of a given problem, and that headquarters will feel comfortable in doing so.

Long-standing business or cultural ties between the company or its country and the location in question suggest the existence of certain shared values and institutional mechanisms for resolving disputes. When these are present, companies may be more willing to let events run their course without significant corporate intervention.

When local units obtain financial control of a subsidiary and local managers are appointed to top positions in the absence of these essential preconditions, little real authority is evidently gained for the local manager. Considered as isolated factors, local financial control of the unit, or a local national as head, do not contribute substantially to the independence of that branch. While these elements are viewed as significant by some companies, they are not considered important by as many firms as confidence in the manager, unit size, and an established relationship with the country. This suggests that local demands do not achieve local participation in

decision making in the absence of a mature relationship between the local interests and the company.

The Pressure of Local Demands

The companies surveyed have not found local demands to be an insurmountable problem. While individual cases of companies withdrawing from, or refusing to do business in, a country because of these conditions make good reading in the business press, they are rare, at least among the responding companies, and, for the most part, the participants do not feel that these local difficulties are likely to lead to withdrawal decisions in the future.

Where a company has left a country, it is generally due to a seismic shift in the country's basic system of political values such as took place in Iran. Even in Iran, however, the government has made discreet overtures to certain companies to return, and these firms have not rejected them out of hand.

In contrast to the Iranian case, most of the countries mentioned by companies as making demands generally have political and economic value systems which the companies can accommodate, even if they do not share or support them.

As the companies see it, local interests do not realistically expect them to capitulate to their demands. Rather, companies expect to participate in an ongoing negotiating process with local governments to isolate those issues on which there can be agreement, to define areas where a certain amount of give and take is possible, and to identify conditions that the company is unwilling to discuss.

How has this negotiating process affected the patterns of decision making and the position of the local manager? First, a major focus of local demands is on the financial processes and policies of the company. The most prevalent local demands are for financial participation. Limits on repatriation of assets and on the

charging of research fees by the company's central laboratories are also quite common. In addition, a significant number of countries are insisting that the company establish local research or development facilities, and these units often require large capital expenditures. It is further evident that the power to spend and invest are among the prerogatives most zealously guarded by parent corporations. Indeed, in the presence of local ownership interests and attempts by local governments to increase the company's local investments, a significant number of firms have actually reduced the authority of their local managers for capital-spending decisions within the last ten years.

In contrast, when purely business decisions involving purchase of commodities or component parts and production requirements or limitations are involved, it appears that companies are willing to negotiate. They do not feel that these conditions have the same potential negative impact on their efforts to manage a worldwide concern and they allow their local managers more freedom of action in discussions with local interests than is generally the case with financially sensitive decisions.

Companies continue to feel that the choice of top managers for local subsidiaries is an important decision for corporate headquarters. However, the increasing availability of adequate, and even superior, candidates in most parts of the world has reduced tensions over this issue.⁴

Finally, the authority, which has increased over the last ten years, for local managers to deal with labor relations and local political issues suggests a substantial commitment to a negotiating process. Companies are interested in establishing a vehicle for discussion and accommodation, and they are trying to chart a middle course between the extremes of confrontation and capitulation.

⁴Ronald E. Berenbeim, 1982.

Chapter 2

Decision Making in Local Subsidiaries

NOT SO LONG AGO, the head of a subsidiary in a foreign land invited comparison to Shakespeare's Prospero: An individual, possibly with little or no experience either of the business or of the country, would find himself in a strange and remote outpost. And in that harsh and uncongenial climate, the manager was expected to fashion a kingdom with all the accoutrements of civilization.

For its part, the parent company found itself in the position of another Shakespearean character, Glendower, who boasted that he could "call spirits from the vasty deep." The response to that claim was a question: "Will they come when you do call for them?"¹ Indeed, that question could not always be answered in the affirmative. A Caribbean branch bank manager once told a Conference Board researcher that his phone invariably went dead whenever headquarters called with an unwanted order.

These images of exploration and sorcery, however oversimplified, go a long way toward explaining, or at least making intelligible, important perceptions that underlie the relationship between parent companies and their foreign subsidiaries; or, at least, they did at one time. As more managements develop more experience, a different concept of the local manager's role is emerging. Today's local manager is more of a diplomat than a magician, and the individual's charter is that of representative and chief local negotiator for the parent company. As to actual management of the local concern, companies have increased their involvement in its decision-making processes, particularly where large capital expenditures are at issue.

But if the vast majority of companies no longer describe the heads of their local subsidiaries as fully

independent, neither do they consider them to be mere agents of top management. The companies regard their local unit heads as entrepreneurs, a status that is midway between the magician-explorer of the past and that of a mere functionary.

Indeed, a few companies, most of them European, see the relationship between headquarters and its larger local units as evolving from a parent-child to a brother-sister involvement. In many instances they have found that the experience and resources of big subsidiaries rival their own. This development, however, is still in the future for most companies.

Decision Making: Some Basic Principles

Although these concepts are helpful, it is important to stress the point (made at the outset of Chapter 1) that the exercise of authority is highly personal and situational. Companies deal with their local units on a case-by-case basis and resolve the tension between the need for flexibility at the local level and the requirement of oversight on the basis of individual needs and circumstances.

A second caveat in examining the significance of decision-making authority is that the issue of who has the final authority is only a part of the total *process* of decision making. In many instances, parental approval may be required for a certain action but that embraces a continuum of corporate behavior from a direct order, consultation and approval, veto and, at the other end, passive ratification.

A third caveat is that whatever a manager's final authority may be, the individual may not choose to use it. Managers may wish to involve headquarters in decisions—even when this is not strictly required—due to a lack of local experience or information, or because it is politically prudent to have additional support for a decision.

¹William Shakespeare, *Henry IV, Part I, Act III, Scene i, The Riverside Shakespeare*, Boston: Houghton Mifflin Co., C. 1974.

A fourth point is that local demands for particular company actions have not, by and large, been successfully translated into local participation in related company decisions (Table 1). For example, 51 companies reported local pressures for the appointment of nationals to top-management positions, but the authority of the local unit for selecting the local manager is low and has not increased in most companies during the last ten years.

Fifth, those companies that consider local pressures to have had a severe effect on their ability to manage the company have not been noticeably more willing to increase the local manager's decision-making authority except in two areas: labor and political relations.

Sixth, there is considerably more local independence where local investors actually control the enterprise, or the local partner is the government, but even under those circumstances, the parental retention of authority for the decisions examined remains considerable.

Local minority interests are also bound to have some effect on the nature of the process. These individuals, for example, will have access to information, a voice, and possibly even a vote, in subsidiary deliberations. Still, their presence has little effect on the actual independence of the local unit for making these kinds of decisions.

Decision-Making: The Pattern

Nine of the ten decisions mentioned earlier as being a representative indication of the decision-making authority of heads of local subsidiaries fall into five basic categories: (1) business decisions, (2) capital expenditures, (3) labor and political negotiations, (4) top-management selection, and (5) territorial or jurisdictional decisions. The tenth local action, the establishment of a research or development laboratory, relates to several of these categories.

The pattern that emerges shows a high degree of retention of parental authority for all but the business, labor and political situations. In addition to a lower level of parental involvement for these actions, a significant number of companies have also increased their local managers' authority during the last ten years for dealing with these problems. At the other end of the spectrum, corporations are especially zealous in guarding their capital-expenditure prerogatives, and a significant number have actually reduced the local managers' freedom in the last decade for these kinds of decisions (Table 2 and Chart 1).

In addition, there are no hard-and-fast rules that serve

Table 1: Relationship Between Local Demands and Company Decisions

<i>Local Demand</i>	<i>Related Company Decision</i>	<i>Local Unit's Degree of Authority</i>	<i>Change in Local Unit's Degree of Authority in Last 10 years</i>
Financial Participation	Enter Joint Venture	Low	Decreasing
	Select New Director	Low	Unchanged
Appointment of Nationals to Top Positions	Select New Head	Low	Unchanged
	Select New Director	Low	Unchanged
Research Facility	Establish Research Facility	Low	Increase and Decrease
Restriction on Research Fees and Limits on Repatriation of Assets	Acquire Local Business	Low	Decreasing
	Enter Joint Venture	Low	Decreasing
	Build New Plant	Low	Decreasing
	Build Research Laboratory	Low	Increase and Decrease
Local Purchase of Component Parts or Raw Materials	Build New Plant	Low	Decreasing
Limit Production Levels	Build New Plant	Low	Decreasing
	Enter New Territory	Low	Decreasing
Limit Share of Local Markets	Introduce Product	High	Increasing
	Build New Plant	Low	Decreasing
	Enter New Territory	Low	Decreasing
Produce or Sell Product as a Condition of Entry	Build New Plant	Low	Decreasing
	Build Research Laboratory	Low	Increase and Decrease
	Enter New Territory	Low	Decreasing

Table 2: Changes During the Last 10 Years in the Local Managers' Authority for Key Decisions (109 Companies)¹

	<i>Number of Companies Where Local Managers' Autonomy is . . .</i>		
	<i>Greater Now</i>	<i>Less Now</i>	<i>About the Same</i>
Decision to introduce a new product for sale in local market (product developed by parent)	33	11	63
Decision to acquire or sell a local business or facility	7	12	89
Decision to engage in joint venture with a local partner	10	17	81
Negotiation of sensitive political issues with local government	31	13	63
Building of a new plant within territory of a foreign branch or subsidiary	4	18	85
Negotiation of a labor contract with local union	28	5	73
Selection of a new head of local operating unit (incumbent's successor)	5	13	90
Decision to establish local research or development facility to serve local needs	12	13	83
Selection of director for board of branch or subsidiary	9	3	95
Decision by regional or local units to enter a new country	5	17	83

¹Not all companies responded to all items.

for all subsidiaries and all companies. Labor relations is the activity with the lowest degree of corporate involvement, but a substantial number of companies do require that at least one of their local subsidiaries obtain parental approval during the course of labor negotiations (Tables 3 and 4).

The pattern that emerges is one of stricter financial controls and greater local freedom for labor, political and business decisions. It suggests that headquarters is beginning to regard the local manager's charter as somewhat entrepreneurial in character.

This pattern of local entrepreneurialism is likely to be most pronounced in companies with technologically based products that require large expenditures for research, plant and equipment. In contrast, the principal expense in consumer product companies come from advertising and marketing, which are not always subject to these kinds of corporate constraints.

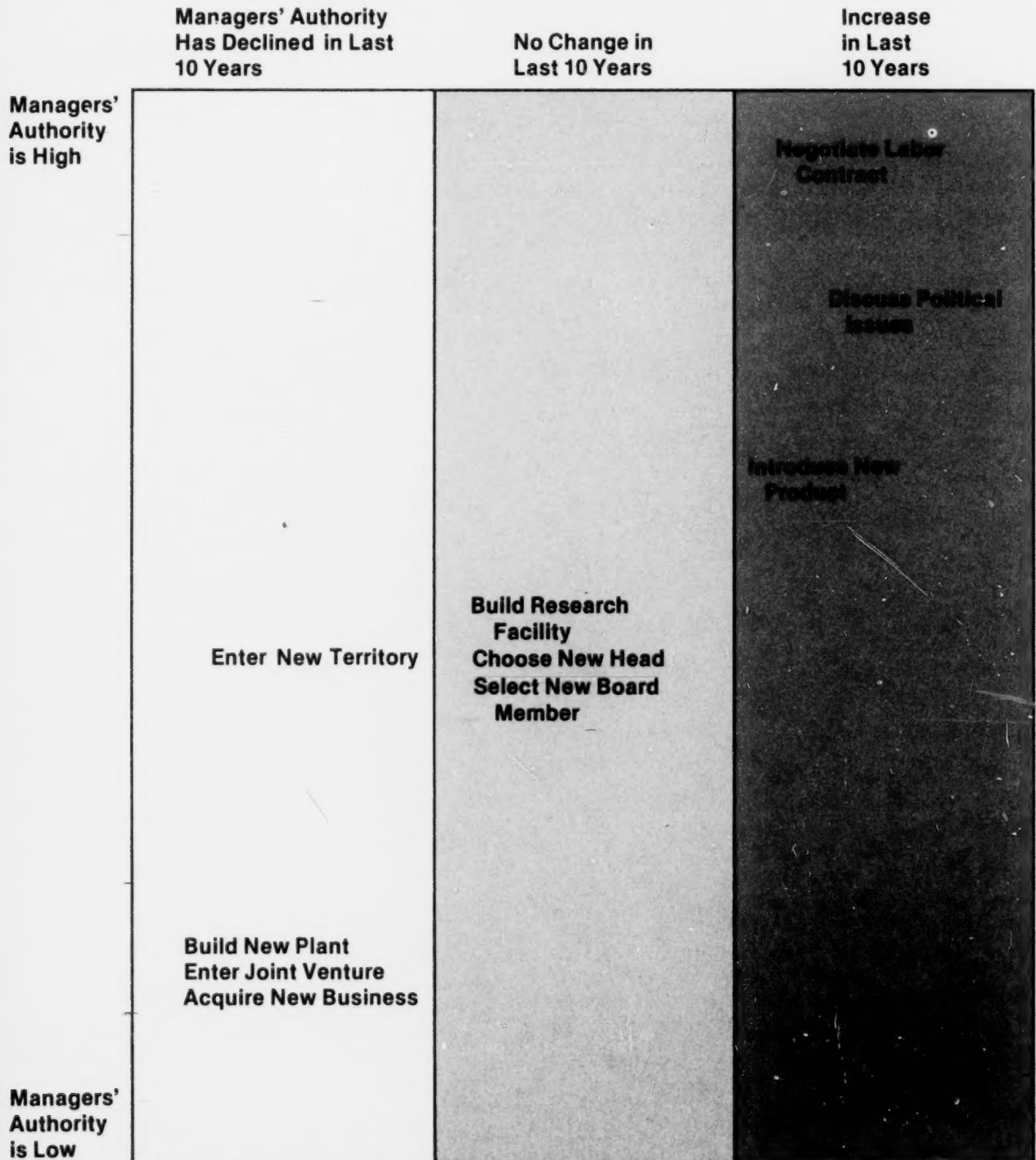
One individual, whose company is active in both the technological and consumer areas, noted the difference: "In building a new plant in the territory of a foreign branch or subsidiary, all of the local managers have virtually no authority because of the size of the capital expenditure. The procedures for the approval of capital

expenditures do not vary by geography. The exceptions are not based on the region, but on the nature of the expenditure. For example, marketing and advertising expenses do not get the same kind of corporate review and approval that capital expenditures are given. If you look at the consumer businesses, and this is probably true in other companies, marketing is the biggest expense."

There is another potential explanation for the contraction of managerial authority in certain areas within the last ten years. Ten years ago, many of the companies that participated in the current survey were new to foreign operations. The local manager's primary job was to establish the operating structure of the business of which plants and research facilities are primary elements. This involves essentially technocratic functions such as engineering and design, and entails the management and oversight of a large financial investment. Once the corporate presence is established, there is a need for a different type of individual; someone who is skilled in the functional aspects of the business—production, marketing and sales. What is needed at this point is a person who can develop the infrastructure (organization and people) of the local operation rather than the superstructure.

Chart 1

Degree of, and Change in, Local Managers' Authority for Key Decisions



* A significant number of companies have increased authority and an equally significant number have decreased autonomy. Thus, the overall picture is "no change."

Table 3: Decision-Making Authority of Heads of Local Units (109 Companies)

<i>Nature of Activity</i>	<i>Number of Operations Where Head of Local or Regional Unit has:</i>		
	<i>Full Authority</i>	<i>Authority to Take Action, but Must Consult with Higher Level</i>	<i>Authority to Recommend; Parent Must Approve any Major Action</i>
Capital Expenditures			
Acquire Local Business	3	19	299
(Local Interests Control)	5	14	59
Enter Joint Venture	4	30	288
(Local Interests Control)	5	17	56
Build New Plant	8	24	285
(Local Interests Control)	4	21	52
Miscellaneous			
Build Research Facility	16	63	255
(Local Interests Control)	9	24	46
Top Personnel Issues			
Choose New Director	9	74	241
(Local Interests Control)	6	30	40
Select New Head	15	78	226
(Local Interests Control)	7	34	37
Territorial and Jurisdictional Issues			
Enter New Territory	7	60	241
(Local Interests Control)	6	20	48
Business Decisions			
Product Introduction	62	98	150
(Local Interests Control)	17	25	32
Labor and External Relations			
Discuss Political Issues	60	186	68
(Local Interests Control)	22	38	14
Negotiate Labor Contract	175	124	15
(Local Interests Control)	57	19	5

In addition, a company with more extensive foreign activities is likely to develop more jurisdictional issues that have to be mediated at company headquarters. When the company's only operation in South America is in Brazil, the local manager may have ample discretion to move into other Latin American countries. When the

company also has a unit in Argentina, it becomes a question of who has the authority to enter the new country. This potential for conflict may be the reason why about one-sixth of the participating companies (17) now gives their local managers considerably less autonomy in this regard.

Table 4: Pattern of Decision Making by Company (109 Companies)

<i>Nature of Activity</i>	<i>Percentage of Companies in Which at Least One Head or Local Unit has:</i>		
	<i>Full Authority</i>	<i>Authority to Take Action, but Must Consult with Higher Level</i>	<i>Authority to Recommend; Parent Must Approve any Major Action</i>
Capital Expenditures			
Acquire Local Business	7	31	100
Enter Joint Venture	8	44	100
Build New Plant	9	43	100
Miscellaneous			
Build Research Facility	16	63	100
Top Personnel Issues			
Select New Head	21	100	100
Choose New Director	10	98	100
Territorial and Jurisdictional Issues			
Enter New Territory	7	60	100
Business Decisions			
Product Introduction	42	50	85
Labor and External Relations			
Discuss Political Issues	77	100	77
Negotiate Labor Contract	100	100	19

Chapter 3

Local Conditions and Decision Making

IN ASSESSING the pattern of decision-making authority for local managers in foreign subsidiaries, it is worth noting that local interests, particularly governments, are seeking a role, both directly and indirectly, in company deliberative processes. No examination of the delegation of authority between parent and foreign subsidiary would be complete without some examination of these local demands, why the countries make them, and the extent to which they affect, or do not affect, the local managers' independence from company headquarters.

Interviews with executives in the United States, Canada and Europe have identified nine key problem areas as being of special concern in managing worldwide operations. Five of these demands characteristically arise in countries that have not yet reached an advanced industrial stage (though most of these have a *significant* level of local industry) and are identified by the participants as growth markets. The other four local conditions arise in all kinds of countries, some of which are highly industrialized and considered to have relatively limited prospects for significant business growth.

Local interference with company decision-making that was examined falls into one of three different kinds of activities: (1) financial and investment decisions, (2) personnel, and (3) business decisions. With one exception (demand for local research facility or technology transfers), interference by the host country with capital-expenditure decisions is more likely to arise in countries with a relatively low level of industry. Problems with personnel and business-oriented decisions often occur in heavily industrialized as well as in less industrialized countries.

Financial and Investment Decisions: (1) Local interests are demanding financial participation in the company enterprise, either directly or through local governments. This problem was far and away the most prevalent. Eighty-five companies reported two hundred and five incidents of this sort. The great majority of these demands came in regions where the companies expect

significant growth (Latin America and Asia), and in countries with a low or moderate level of industrialization.

(2) Local governments are imposing restrictions on the company's ability to charge local units research fees for work done in its central laboratories. This problem tends to occur in significant growth markets that have a low or moderate level of industry.

(3) Local governments are attempting to limit repatriation of assets. Most respondents experienced this difficulty in significant growth markets with a low or moderate level of industry.

(4) Local interests or governments are demanding that the company establish a research facility or transfer important technology within or to the country in which the company is doing business.¹ This can happen almost anywhere. Canada and France (low anticipated growth, high level of industry) rank second to India in the number of reported incidents. As already noted, the research decision, although it may involve large capital expenditures, also resembles the profile for personnel issues. Broadly construed, it is understandable why this is the case. From the point of view of the countries in question, research and technology-transfer conditions may be personnel issues in that the driving motive is the employment, training and improvement in the basic skills of the local population. The investment of large sums of money by the company is not an end in itself, but, rather, a necessity if the country is to achieve that objective.

Personnel Issues: (5) Local interests or governments are demanding that local nationals be appointed to top-management positions in local-company operations. As with research facilities, personnel-oriented conditions can arise in any country for a variety of reasons. The three

¹James R. Basche, Jr. and Michael G. Duerr, *International Transfer of Technology—A Worldwide Survey of Chief Executives*. The Conference Board, Report No. 671, 1975; James R. Basche, Jr., *Technology Imports into the United States*. The Conference Board, Research Bulletin No. 129, 1983.

countries most often making the demand are Canada, Nigeria and Japan.

—Canada, a Canadian executive suggested, “is reacting to a long period of domination by Britain and the United States. In the case of Britain, the domination was cultural; with the United States, it was primarily economic. Whatever the inherent motive, the effect on British and American companies is similar.”

—Nigeria’s presence in this group is explained by the desire to improve its infrastructure through opportunity and training.

—Japan’s inclusion may result more from a perceived necessity by the companies than from insistence on the part of the Japanese. By virtue of Japan’s intricate internal market system, a number of those interviewed also commented that it would be impossible to do business in Japan without a Japanese at the head of local operations.

Business Decisions: (6) Local interests or governments are requiring that component parts or raw materials be purchased from local suppliers. This problem is characteristic of high-growth countries with a low or moderate level of industry.

(7) Local governments are imposing limits on the level of production. This demand does not arise very often. It is characteristic of the high growth, lower industrial level countries. Inasmuch as interview participants have commented on the need of these countries for high production levels to help with their balance-of-payment problems, this condition has not often been imposed in recent years.

(8) Local governments are limiting the company’s share of local markets. All kinds of countries do this but they do not do it frequently. The most likely explanation is the local government’s desire to regulate internal competition. As these situations are infrequent, they are probably best explained on a case-by-case basis. It is likely that in many instances a local competitor (it may even be another multinational) has leverage with the local government.²

(9) Local governments are insisting that the company produce or sell certain products as a condition of entry into local markets. This problem arises in both advanced and less industrialized countries. One interview participant likened it to the research laboratory requirement in that it entails a demand that the company establish a capacity within a country where none has existed in the past. Not surprisingly, the two countries that lead this list are Brazil and Mexico. These countries have enormous debt-servicing problems, and this approach may be part of their strategy to generate the wealth to meet these commitments.

²Allen R. Janger and Ronald E. Berenbeim, *External Challenges to Management Decisions: A Growing International Business Problem*. The Conference Board, Report No. 808, 1981.

³Janger and Berenbeim, 1981.

Countries that Make Demands: Some Important Characteristics

Looking at these local demands, it is possible to plot the positions of particular countries on a chart that takes into account the level of industry and the degree of growth anticipated by survey participants for that particular country (Chart 2). The result of this exercise is that the three countries with the highest number of local demands (Brazil, Mexico and India) are located in the center of the chart. This is the point on the axis for countries with a moderate level of industry and a fairly substantial degree of anticipated growth.

Where there is little industry and a low level of expected growth, relatively few problems occur (China). By the same token, advanced industrial countries with a fairly high-growth potential do not impose onerous conditions with great frequency (the United States).

Difficulties do occur in countries that interview participants identified as high growth but with a low industrial capacity (Nigeria, Indonesia). Perhaps the most vexing problems of all occur in countries that are highly industrialized but are considered to have limited growth prospects (France, Canada).

As noted on Chart 2, local demands are most likely to occur in countries that have reached a certain level of industry and market growth, but the problem is not limited by these situations. One prominent European executive observed that the predictability of local conditions often defies regional expectations:

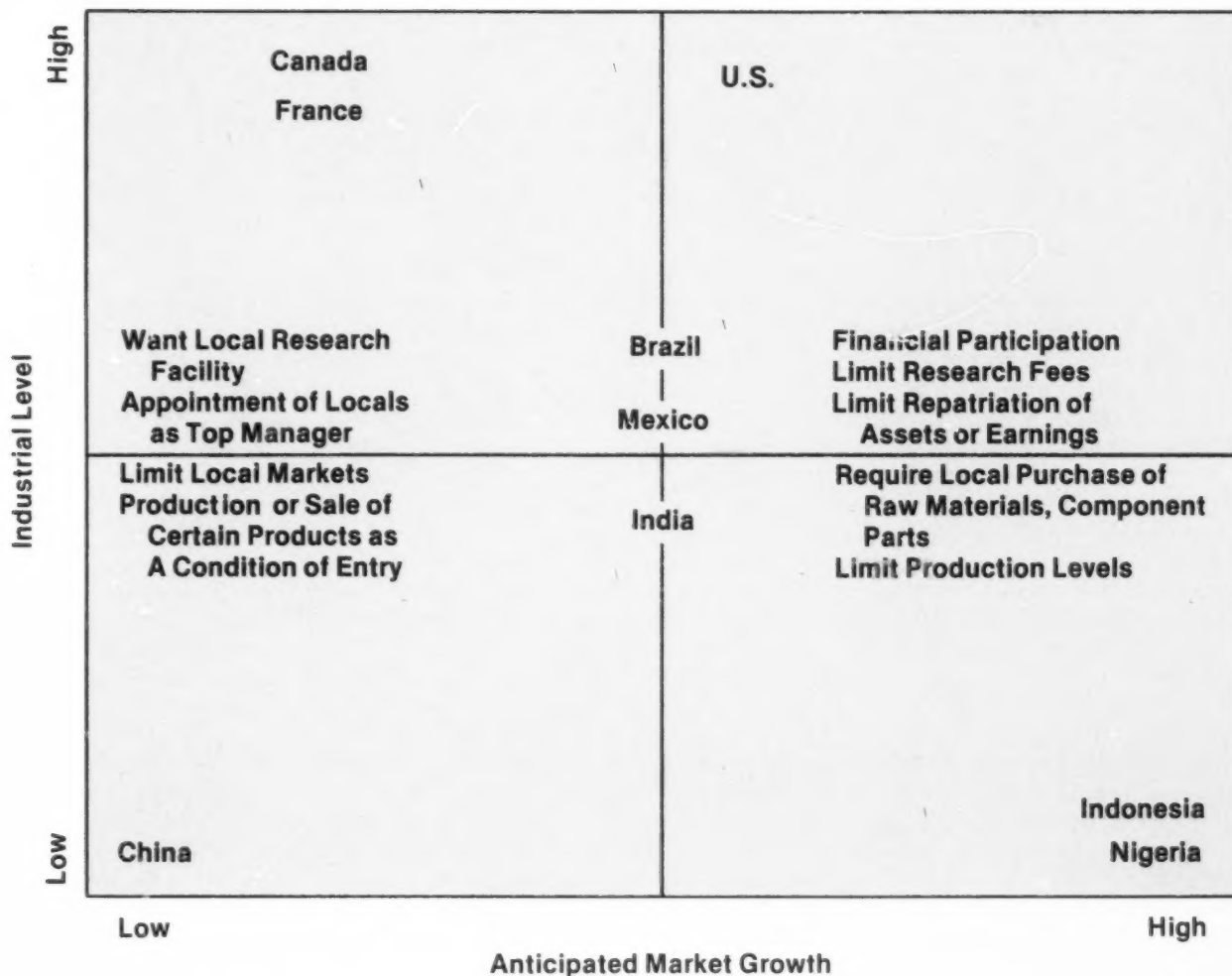
“We have a special term for it in our company jargon. We call it the ‘ization’ problem. And it is interesting to see that ‘ization’ pressure is not correlated with the type of government. We meet it in South Africa on the one hand, and Peru on the other. So there is no correlation at all; I think that there is always a fairly strong emotional, nonrational component in this respect when the government makes policy. You find it in pro-market economies like South Africa, and you meet it in state capitalistic countries like Chile. It is more a matter of national pride, and possibly an issue of national security. It can be motivated by a desire to establish incentives to develop a capitalistic society, but it can also be caused by a need to provide conditions for the growth of a socialist state. The motives are different in every case.”

Moreover, as this individual continued, governmental behavior is seldom consistent and often changes abruptly due to the pragmatic and experimental nature of politics and the need to accommodate the various sectors within the national community:

“You see the governments in the course of time, going in, coming back, and then going in again. It is not a steady process. We do business in a country where they will want to nationalize, and then they give it back to us.

Chart 2

Prevalence of Local Demands by Industrial Level and Anticipated Market Growth



Then they get very modest and say: 'If you want to keep 60 percent, it is all right with us.' Then, a little later, they will say: 'You take 55 percent, we do not want the responsibility.' Fifteen years later they come back and want the 55 percent. It is erratic, and depends on irrational factors. Complete nationalization and then inviting you back has happened at least three or four times in certain countries in my lifetime.

"There are other cases where you must go in as a minority because you do not fulfill their export requirements for high technology. Then five years later they take another look and offer you a majority position."

Survey responses substantiate the view that it is very difficult to characterize on the basis of political or

economic systems the kind of country that is most likely to make one of the nine demands that are the focus of this study. Still, for the most part, the countries that are mentioned most often do have certain characteristics in common:

(1) *Nationalism*: Nationalism can, of course, take many forms and it is difficult to think of any country in the current worldwide environment that does not pursue the policies of economic nationalism to some degree. Those countries, however, that are most frequently mentioned tend to be large enough to feel that they have an important role to play in the international community. They think that they are sufficiently rich in human and natural resources to be capable of "going it alone" to a significant degree if their policies discourage foreign

companies from investment and trade. In short, these countries, by virtue of some combination of important markets, cheap labor, and abundant natural resources believe that they have more to gain by imposing these limitations than they do by affording foreign firms full cooperation. For most, the risk has paid off. The constraints have caused relatively few companies to refuse to do business within their countries.

(2) *Doing business within the country is profitable:* Those countries most often mentioned are the regions where the largest number of companies surveyed do business. Thus, these countries are profitable for a large number of firms engaged in a wide variety of enterprises. Interviews also support this view. Many U.S. and European executives commented in so many words: "We do not like these conditions, but the local operation remains profitable and we will do what we have to to stay there as long as it remains profitable."

(3) *Countries most frequently mentioned have achieved an important degree of industrialization:* Countries at the top of the list may not have advanced industrial economies, but neither are they totally undeveloped. In each case they have achieved a certain critical mass with respect to local capital, labor skills, and consumer markets. In many cases, they also have abundant natural resources that they do not want to see exploited by nonnationals. Many of the countries that are mentioned frequently are those with rising expectations as to their futures.

(4) *Power of the state:* Regardless of the political system of the countries most often mentioned, they are, by and large, countries where the state, whatever the source of its mandate and authority, is enormously powerful. This power has two important characteristics.

First, governmental organization is heavily centralized in a single national apparatus and the national government has vast discretion to promote the national interest and the general welfare of the citizenry. Among the countries where difficulties are most likely to occur, Canada is the only one that has a strong system of state and provincial governments. Although federalism may be on the books in India, Mexico and Brazil, the state governments are decidedly subordinate to the national government in determining their relationship with foreign businesses.

Second, it is likely that there is little or no tradition of separation of powers and "countervailing forces" are weak, and, in some cases, nonexistent. Thus relatively few problems have arisen in countries like Great Britain and the United States that have a strong tradition of intervention of the legal system to protect the rights of individuals against the claims of the state. By the same token, Great Britain, a country where strong labor unions exist as a "countervailing force" to the power of the state has many fewer incidents than France, which

has the weakest labor unions of any major country in Europe. Further, with respect to France, the power of the state in deciding economic issues is probably more important than that country's current socialist government in explaining the large number of episodes reported there.

Effects of Demands on Companies

Most executives do not believe that these demands have a significant impact on the management of their companies. There were exceptions to this rule. In each of the nine problem areas there were companies that judged a particular requirement to have a severe effect on the worldwide management of their firms. Among survey participants, the local condition that was considered most troublesome by the largest number was the limitation of repatriation of assets or profits. Other restrictions that were considered significant were demands for financial participation, restriction on charging local unit fees, requirements that raw materials or component parts be purchased from local suppliers, and limitations on the share of the local market (Table 5).

When interviewed, executives tended to minimize the impact of these local conditions on company operations and stressed their organizations' flexibility and adaptability. One manager, whose company had experienced most of these difficulties in one form or another, summed up the general view: "Many of these situations have come up in the countries where we operate but I do not think that they have restricted our opportunities in these places. That does not mean that life would not be simpler if some of these things had not happened, but we pride ourselves on being flexible enough to react to any conditions at a given time. I really do not think that these problems have restricted our ability to do business in any of the countries in which we operate."

Although most of those interviewed would agree with this observation, which was summarized by the opinion that "we can live with anything," companies also reported that these local demands were fairly common and that, in certain instances, they expected them to increase (Table 6). Although the local conditions in most cases were not viewed as having a severe effect on efforts to manage the company worldwide, in every example but one (limits on local production) these demands resulted in at least one company not doing business within a certain country. And in each case, some companies said that a particular local condition *could* result in their not doing business within a certain country (Table 7). Companies were fairly evenly divided between business (profitability) and management (control) explanations as to why this has been true in the past, or why it might happen in the future (Table 8). The responses also suggest that there is not always a direct correlation in this context between increased costs or difficulty in controlling the local

Table 5: Effects of Local Demands on Corporate Decision Making (109 Companies)

<i>Condition</i>	<i>Minimal or No Effect</i>	<i>Moderate, Serious or Severe Effect</i>
1. Local governments are attempting to limit repatriation of assets or earnings.	46	62 ^a
2. Local interests are demanding financial participation in the company enterprise, either directly or through local governments.	53	56
3. Local governments are imposing restrictions on the company's ability to charge local units research fees for work done in its central laboratories.	58	49 ^a
4. Local interests or governments are requiring that component parts or raw materials be purchased from local suppliers.	60	49
5. Local interests or governments are demanding that the company establish a research facility or transfer important technology within or to the country in which the company is doing business.	74	30 ^a
6. Local interests or governments are demanding that local nationals be appointed to top-management positions in local company operations.	77	32
7. Local governments are limiting the company's share of local markets.	77	26 ^a
8. Local governments are insisting that the company produce or sell certain products as a condition of entry into local markets.	79	28 ^a
9. Local governments are imposing limits on levels of production.	84	23 ^a

^a = Not every company responded to the item.

operation and the decision not to do business in a specific country. Of the two local conditions that were cited by the largest number of respondents as increasing the cost of doing business (demand for local financial participation and requirement that component parts or raw materials be purchased from local suppliers), only the demand for local financial participation has resulted in a significant number of companies not doing business in specific countries.

Among the two conditions most often mentioned as making the control of the local operation more difficult, the demand for local participation, and the requirement that local nationals be appointed to top positions in countrywide operations, only the former (which also has important cost impact) has caused a significant number of companies not to do business in a certain country.

Finally, limits on repatriation of assets have resulted in a number of companies avoiding countries that impose this condition, but it was mentioned infrequently as contributing to increased costs or to difficulties in controlling the local operation. One executive commented on why the repatriation problem is so important

even though it may have a relatively modest impact on profitability or controls: "The danger in the whole area of repatriation of assets is that you are forced into making decisions on that basis alone, and these may not be the right business decisions. If you cannot get your money out of a country you have to reinvest it in that country, and that is all right as long as it is the best use for the money.

"Take Brazil as an example. We have been there for 50 years and its economy has been growing for those 50 years. Maybe it will continue to grow and the people will become more affluent and there will be increased demand for our products. But if that does not happen, we will find ourselves in a position of having invested almost to the saturation point and having no where else to go."

Special Problems with Local Demands: Financial Participation

Of all the local factors, the demand for local financial participation was the most prevalent, and many companies also regard it as the most serious. Local financial

Table 6: Frequency of Local Demands and Expectations as to Future Occurrences (109 Companies)

<i>Condition</i>	<i>Has Occurred within Last 10 Years</i>	<i>Expect More Frequent Demands in Next 10 Years</i>
1. Local interests are demanding financial participation in the company enterprise, either directly or through local governments.	85	67
2. Local governments are attempting to limit repatriation of assets or earnings.	69	35
3. Local interests or governments are requiring that component parts or raw materials be purchased from local suppliers.	62	36
4. Local governments are imposing restrictions on the company's ability to charge local units research fees for work done in its central laboratories.	52	31
5. Local interests or governments are demanding that local nationals be appointed to top-management positions in local company operations.	51	32
6. Local interests or governments are demanding that the company establish a research facility or transfer important technology within or to the country in which the company is doing business.	41	32
7. Local governments are insisting that the company produce or sell certain products as a condition of entry into local markets.	28	17
8. Local governments are imposing limits on levels of production.	20	9
9. Local governments are limiting the company's share of local markets.	19	7

participation (in some cases, control) affects the utilization of corporate resources and also the corporate share of the profits. One participant expressed this view in general terms: "Local participation can interfere with the free flow of the best technology available for each market. When you slow the development of the local units this can sometimes result in the loss of management control over the decision-making process."

Others were more specific as to the kind of impact local financial participation had had on their companies. Certain industries, like mining, that require large capital investment for important projects, sometimes find that local sources are insufficient to fund certain ventures. One European executive noted this problem: "The requirement that local interests have more than 50 percent can restrict the ability of the company to develop when the local capital market is not large enough. We have also found that in some cases, where there is a restriction on foreign ownership, the company is not always allowed to fully develop its own resources."

Another problem with local ownership is that companies in industries such as pharmaceuticals that require

a long wait for a return on investment sometimes find that local investors get impatient for results. An individual in a U.S. pharmaceutical company commented: "We like to own 100 percent of a local company so that we can manage it as we see fit. We want to be free to expand or not to expand, and not to pay dividends if there is a need to pump money back into the business. Our products are such that in the beginning there is a tremendous expenditure on promotion and development. Sometimes the local investor would rather take money out than build for the future. We try to establish our products first. If you have a local investor, he may not be willing to wait."

In other cases, the objection to local financial participation is that it results in an inequitable distribution of corporate resources. An executive with a multinational European firm alluded to this problem: "In practice, a 100 percent-owned company gets a lot of service, a lot of access to corporate resources. If it is not a 100 percent-owned company, it still is likely—unless conditions change radically—to get much the same level of access to corporate resource. This means that the shareholders of

the 100 percent-owned company are providing benefits to the shareholders of the 40 percent-owned company.”

Local participation can affect profitability, as well as management. A high-level executive with a European company illustrated this point: “Take our Nigerian operation as an example. It comes down to this, if the business does reasonably well, you are forced to divest yourself of a major portion of a profitable enterprise. This is confiscatory. It is a profitable operation and we would like to keep as much of it as we can.”

While survey responses and interview comments suggest that the demand for local financial participation is a serious problem, and is likely to become more so in the next ten years, a few participants saw local financial participation as something of a red herring. A U.S. oil executive recalled somewhat ruefully: “We had 100 percent in Libya and it didn’t do us a bit of good.” A European put it somewhat more elegantly: “The equity issue is secondary in comparison to the pyramid of government policies and regulations.”

Special Problems with Local Demands: Research Facilities

Among the other conditions examined by the survey only one, requirements for local research facilities, was a frequent topic of discussion among those interviewed. This came up in a variety of contexts. The head of research and development of a high-technology European company expressed concern that implementation of this requirement in less-developed countries would cause the research capacity in his company to atrophy: “It is very hard, if not impossible, to develop a product in a community that does not have a demand for it. If I pick up a product-development group here and put the same competent guys into a less-developed country where there is no demand for the product, after two years they would not function any more. Now that means if you develop high-technology products you must do it in an environment where there is a demand for these products. It would be very difficult

Table 7: Company Response to Local Demands (109 Companies)

<i>Condition</i>	<i>Has Resulted in Company Not Doing Business in a Specified Country</i>	<i>Could Result in Company Not Doing Business in a Specified Country</i>
1. Local interests are demanding financial participation in the company enterprise, either directly or through local governments.	23	34
2. Local governments are attempting to limit repatriation of assets or earnings.	17	30
3. Local interests or governments are demanding that the company establish a research facility or transfer important technology within or to the country in which the company is doing business.	5	18
4. Local governments are imposing restrictions on the company's ability to charge local units research fees for work done in its central laboratories.	4	12
5. Local interests or governments are requiring that component parts or raw materials be purchased from local suppliers.	4	15
6. Local governments are insisting that the company produce or sell certain products as a condition of entry into local markets.	4	12
7. Local interests or governments are demanding that local nationals be appointed to top-management positions in local company operations.	2	5
8. Local governments are limiting the company's share of local markets.	1	12
9. Local governments are imposing limits on levels of production.	0	10

Table 8: Impact of Local Demands (109 Companies)

<i>Condition</i>	<i>Cost of Business Is Significantly Higher than Elsewhere</i>	<i>Has Made Controlling Local Operation More Difficult</i>	<i>Has Impaired Our Ability to Compete with Local Businesses in the Country in Question</i>
1. Local interests or governments are requiring that component parts or raw materials be purchased from local suppliers.	27	9	5
2. Local interests are demanding, either directly or through local governments, financial participation in the company enterprise.	15	42	12
3. Local governments are limiting the company's share of local markets.	6	1	8
4. Local interests or governments are demanding that the company establish a research facility or transfer important technology within or to the country in which the company is doing business.	6	3	3
5. Local governments are insisting that the company produce or sell certain products as a condition of entry into local markets.	5	1	1
6. Local governments are imposing limits on levels of production.	5	5	7
7. Local governments are attempting to limit repatriation of assets or earnings.	4	2	2
8. Local governments are imposing restrictions on the company's ability to charge local units research fees for work done in its central laboratories.	2	2	2
9. Local interests or governments are demanding that local nationals be appointed to top management positions in local company operations.	0	19	1

for us to set up a development laboratory in a less-developed country to service the European and North American markets. The drug and food companies have less difficulty complying with this demand. Their products deal with the physiological functions of the human body and there is a demand for these products everywhere."

The requirement that the company produce certain products as a condition of entry is a variant of the demand for local research or development facilities. It was cited by an executive with a European firm: "The countries call it international product vending. An example of this is General Electric, which has made Mexico its worldwide center for the manufacture of clothes irons. Some governments feel that is a big thing: In giving multinationals access to their market, they ask

in return that the company make their country the focal point for some product. They are not saying directly that you must do research in the country, but it is a manifestation of that kind of approach to the problem."

An executive with a U.S. high-technology company said that his organization has experienced similar problems and viewed them as arising out of the need of less-developed countries for exports: "In Mexico and Brazil they would be happy to see us produce as much as we can because they want the exports. Since we supply a lot of our subsidiaries with products from Mexico and Brazil, the countries in which these companies are located will limit how much you can bring in. In fact, we have had this problem in Brazil. They want us to export what we make in Brazil, but they want to limit what we bring in that is made in other countries."

GEOGRAPHIC AND PRODUCT-LINE ORGANIZATIONS: AN ASSESSMENT

In all but three areas, where both groups experienced problems with comparable frequency, companies organized along geographic lines consistently reported more difficulty with local demands than do product-line organizations.

Do geographically organized companies actually encourage and generate demands in a way that product-line organizations do not? Is the geographic organization simply a company strategy for dealing with a high-demand environment? Is it possible that there is little real difference in the local conditions experienced by these different kinds of companies but that headquarters in geographic firms is more aware of local problems?

The answer to all three of these questions is "yes." By becoming the head of a local unit and, thus, clearly being the company representative, the manager becomes a lightning rod for local grievances.

For companies that organize in this fashion, there may be compensating benefits that offset this greater vulnerability. The company expects that in acting like a local citizen it will be treated like one. Although the burdens and responsibilities are greater, it is anticipated that the privileges and immunities that come with citizenship may also apply to them at certain critical junctures.

Moreover, it is worth noting that the three areas in which both geographic and product-line companies experience pressure with approximately equal frequency are demands that are addressed to corporate headquarters: (1) insistence on top-management positions for local nationals, (2) demand for research facilities, and (3) limitation on repatriation of assets. For this reason, the corporate headquarters of product-line companies may be more aware of them than is the case with other conditions that are more local in nature.

Efforts by Local Governments and Labor Unions to Participate in Decision Making

For the survey participants, the major and, in many instances, the sole source of local pressure on decision making came from the governments of the host countries. In this regard, labor unions were a distant second, but were also considered a factor to be reckoned with in certain countries for some decisions.

Of course, this does not mean that the demands originate with governments, although there are instances where that is the case. It is more of a testimony to the role of government as the advocate and conduit for local concerns in those countries where these kinds of problems are particularly acute.³

Survey responses demonstrate that the major pressure points are the capital-expenditure decisions (Table 9). With regard to capital expenditures, companies are far more likely to encounter difficulty with the government than with the unions. The one exception to this rule is the decision to buy or sell a local business facility. This was the situation in which the largest number of companies (27) reported problems with unions. Even so, an even larger number of firms (32) said that they had recently received a demand by a local government for participation in this decision.

In seeking to participate in capital-expenditure decisions, governments and unions are attempting to interfere with the decision-making prerogatives of which

the parent company is most fiercely protective. Where capital expenditures are concerned, this encroachment may cause the companies to stand firm and many companies have reported that they have reduced the autonomy of the local manager in these circumstances.

As a by-product of the tendency of the governments of certain countries to act in behalf of all of the nation's interest groups, it is worth noting that 14 companies report that governments want to participate in labor negotiations. Even more (18) note that they are receiving more demands of this character than they did ten years ago. This may reflect the changing mix of their international activities. It is reasonable to assume that in many countries the company begins by dealing with the government and it ultimately establishes a direct relationship with the employees or their designated representatives. The increasing demands by government suggest a high level of activity with respect to entering new countries where the government, at least at the outset, is likely to be the sole representative of the work force. There is evidence that this pattern will continue in the foreseeable future because the regions where the most significant growth is expected, Asia (76) and Latin America (52), are areas in which an effort by the local government to participate in labor negotiations can be anticipated.

There are only two situations under which the small number of companies that have encountered any difficulty at all reported that they had had more contact with labor unions than with governments: (1) choice of a

³Allen R. Janger and Ronald E. Berenbeim, 1981.

CONSUMER AND TECHNOLOGY COMPANIES: AN ASSESSMENT

Unlike the other major groupings, company identification as to consumer or technology emphasis requires a problem-by-problem analysis. Four forms of local interference were reported with greater frequency by the consumer group, and four were encountered more often by more technologically oriented firms. In one instance, limits on repatriation of assets, roughly equal percentages of both categories experienced the problem.

In this comparison, the two kinds of companies had vastly different experiences with particular demands. For example, roughly one out of four consumer companies reported local limitations on production levels, while only one out of ten technology companies had this problem.

Some generalizations as to technology and consumer companies are possible. Technology companies were confronted with more demands related to the transfer of technology and industrial capacity. In addition, the greater need of this group for component parts may explain why they encounter the demand for local purchases more often than do consumer companies.

The cost of complying with the local demands more often encountered by companies with a technological bent is quite likely far greater than the local conditions imposed on consumer companies. But the impact of the local restrictions on the management process of technology firms appears to range from modest to nonexistent. In most cases, companies reported a relatively low level of concern with those issues faced most often by this category.

In addition, these particular local demands seldom resulted in refusing to do business in the

country in question. Given the greater pricing freedom of this group, the increased costs of compliance do not appear to have a negative effect on profitability. Thus, the burdens on these companies are primarily financial and they are apparently offset to a significant degree by higher prices.

Consumer firms are more likely to be faced with demands for financial participation and for top-management positions. This may be due, in part, to the more modest capital needs of a consumer business and to the more general, rather than technical, skills needed to manage them. In addition, an investment in a company that markets an established consumer product is likely to have a quicker and more certain return than is the case with a high-technology product. As a result, local interests will want a piece of the action.¹

The other areas where consumer companies encounter greater difficulty are in limits on both production levels and local markets. This difficulty may arise from the local government's desire to regulate competition in local consumer markets. In countries where capital and human resources are at a relative premium, consumer companies are more likely to have local competitors.

These restrictions may be more costly to consumer firms because, in many instances, they have less pricing freedom. As a result, local conditions may cause consumer companies to give more serious consideration to refusing to do business in the country in question.

¹Virginia M. Yorlo, *Adapting Products for Export*. The Conference Board, Report No. 835, 1983.

new head of local operating unit, and (2) selection of director for board of local unit.

This behavior, particularly the latter, is characteristic of advanced industrial countries, and may well be, in large measure, the result of codetermination. The relatively small degree of confrontation over major personnel choices suggests that in most countries governments and unions focus first on how the company

is going to spend its money within the country's borders. Once a stable ongoing relationship has been established, these institutions may become interested in important personnel choices. Indeed, even at that point, interview participants noted that unions are more likely to be interested in the choice of factory managers and top labor-relations appointments than they are about the regional manager or members of the subsidiary's board.

Table 9: Demands by Local Governments and Unions for Participation in Company Decision Making (109 Companies)

<i>Nature of Activity</i>	<i>Local Government</i>		<i>Local Union</i>	
	<i>Company Currently Receives Demands for Participation</i>	<i>Number of Demands on Company Is Greater than 10 Years ago</i>	<i>Company Currently Receives Demands for Participation</i>	<i>Number of Demands on Company Is Greater than 10 Years ago</i>
Business Decisions				
Product Introduction	9	8	4	7
Capital Expenditures				
Purchase or Sale of Local Business	32	36	27	31
Enter Joint Venture	25	29	3	10
Build New Plant	32	34	10	17
Establish Research Facility	15	16	4	8
External and Labor Relations				
Political Negotiations	—	—	8	14
Labor Negotiations	14	18	—	—
Top Management and Board of Directors				
Select New Head of Unit	6	5	8	6
Select New Director for Subsidiary	8	10	12	8
Territorial and Jurisdictional Issues				
Local Unit Enters New Country	8	9	4	6

CAPITAL- AND LABOR-INTENSIVE COMPANIES: AN ASSESSMENT

In eight of the nine problem areas, a larger percentage of capital-intensive firms than labor-intensive companies reported difficulty. In four of the nine areas, the difference in frequency was substantial. (The only area where the likelihood of an incident was approximately equal was in the demand for local purchase of component parts.) Those areas where capital-intensive companies reported a substantially higher level of occurrence were: (1) demand for top-management appointments for local nationals, (2) demand for research facility or technology transfers, (3) restriction on charging of research fees to local units, and (4) limits on repatriation of assets. In sum, of all the major descriptive categories, the term "capital intensive" proved to be the most reliable predictor of whether a company will be faced with local demands.

The result suggests a certain line of thinking that may be common to a great many countries advancing local demands and imposing local restrictions. They are emphasizing investment and research in an effort to improve their internal industrial capacity and infrastructure in the expectation that this infusion of capital and human resources will ultimately generate jobs and income for their citizens. Notwithstanding the wide variety of political systems in the countries in question,

their economic approach appears to be distinctly capitalistic.

Moreover, it is possible that a country's bargaining power with capital-intensive firms is stronger than is the case with the labor-intensive group. The labor-intensive companies have a substantial constituency of local wage earners that could be mobilized in the event that demands became excessive. Capital-intensive companies may also have more pricing freedom and thus may be able to pass the cost of these restrictions on to the ultimate consumer. For this reason they may have more latitude in responding to these demands.

As the foregoing indicates, the explanation for the far greater likelihood that capital-intensive firms will have to deal with local restraints can be found in an analysis of the particular countries imposing the conditions. Their individual needs and their economic outlook (and not their political orientation) as to how these needs can best be achieved is the real catalytic agent for the greater pressure on capital-intensive companies. And it would appear that a most critical element in this equation is, notwithstanding occasional rhetoric to the contrary, the belief of these countries that investment by foreign firms will promote growth and investment.

PROBLEMS OF SINGLE BUSINESSES

The high visibility of a single product or group of products prominently identified with the company probably go a long way in explaining the difficulties encountered by single businesses in foreign countries.

If their product is consistently and universally profitable, and the lack of diversification suggests that this has proven to be the case, local interests want a share of the profits. Governments, as some of those interviewed have noted, are more likely to limit repatriation of assets for two reasons: First, they want the money reinvested in plant and equipment inside the country because they want to become a major manufacturing center for the product. Second, they want the company to export some of what is manufactured in their countries to

improve their balance of payments. Thus, the limitation on local markets, a condition that is also more often imposed on single businesses is consistent with the limitation on repatriation of assets.

The higher incidence of demand for important top-management positions for local nationals may be due to the greater resistance of these companies to this condition. Single-product businesses, by virtue of the limitation of their enterprise, are more centralized and, as a result, may have been less willing to accede to these demands in the past. Thus, they continue to confront them while the more decentralized organizations have already reached on accommodation with local interests.

Chapter 4

Decision Making and Local Financial Control in Perspective

OF ALL the conditions imposed by foreign governments, the one that gets the most attention is the demand for local financial participation. It is the situation most widely experienced by the companies surveyed. It is the area in which the largest number of companies saw governments likely to move against them. It is the demand that most concerned those who were interviewed. It is the condition that could cause the largest number of companies to leave a country, or to refuse to do business there in the first place.

Given this level of concern, the question arises as to whether local ownership leads to a different pattern of decision-making authority. The obvious answer is "yes." But the more important question is how is this difference manifested?

Impact of Local Control on Decision Making

Survey data affirm the impact of local majority participation on the company's efforts in directing and supervising the affairs of its subsidiaries (Table 10). In seven out of ten hypothetical cases, the percentage of companies in which parental approval is required for local actions declines by at least 18 percent when the company no longer controls a majority of the shares. In addition, participation by the local government—even when it does not financially control the local unit—also has a marked effect.

The three areas that were not greatly affected by local control of a majority of the stock (product introduction at the local level; negotiation of sensitive political issues and labor contracts) are ones where there is a great deal of local managerial autonomy under any circumstances. In the case of labor contracts, however, more local managers enjoy full authority in local units where the company has a minority of the shares (70 percent) than have it in a wholly owned subsidiary (55 percent).

The most pronounced loss of corporate authority comes in capital expenditures, the area where retention of control is most important to the company. The biggest

drop in the need for corporate approval in the capital-expenditure area is in the decision to build a new plant. Over 90 percent of the companies require their wholly owned subsidiaries to obtain permission for this action from corporate headquarters, but only two-thirds impose this condition on local units in which they do not control a majority of the shares. This difference may well be due to a change in the structure of financing introduced by local interests. If local interests assume a major portion of the risk, the company may be willing to forego the need for its approval.

There is also a dramatic drop in the level of corporate involvement in the choice of top management and members of the subsidiary board. Once again, it is clear that local control confers certain rights with respect to these important decisions for defining the business and its structure.

Finally, the corporation plays a significantly less important role in this situation when the local organization decides whether or not to enter a new country.

This evidence demonstrates an often repeated assertion by those interviewed: "Where local interests control, the head of the local unit deals with the corporation as though he were the president of a local company with which we do business."

It also demonstrates that the delegation of authority works differently in practice than it does in theory. When asked the more general question of what factors contribute most to a local manager's autonomy, local ownership finished well behind criteria like unit size and length of time the company had been active inside the country. When asked to gauge the impact on specific decisions, the effect appears to be considerably more significant.

Partnership with Local Governments

Although very few companies viewed partnership with local governments as contributing in an important way to

Table 10: Need for Parental Approval for Various Local Decisions and Actions (109 Companies)

Decision or Action	Percentage of Local Units Where Parental Authority Is Required		
	Wholly Owned	Minority Owned	Government Partners
Local Business Decisions			
Product Introduction (Local Level)	45%	43%	56%
Capital Expenditures			
Buy or Sell a Business	94	76	83
Joint Venture	90	72	81
Build New Plant	92	68	77
Build Research Facility	78	58	65
External and Employee Relations			
Negotiate Sensitive Political Issues	24	19	17
Negotiate Labor Contract	3	6	8
Top Management and Board of Directors			
Select New Head of Unit	75	47	57
Select New Board Member	79	53	65
Territorial and Jurisdictional Issues	82	57	63

the delegation of authority to local managers, examination of specific decisions indicate that it does have an important impact. In eight out of ten cases, this partnership results in the retention of the right of parental approval by a smaller percentage of companies than is the case with wholly or majority-owned subsidiaries. The exceptions to this rule are labor contracts, and product introduction.

With labor contracts, for instance, the impact is on those companies that require the local manager to *consult* with corporate headquarters. When the local government is a financial participant in the subsidiary, there is a noticeable rise in the percentage of companies that no longer require any degree of consultation with the parent company.

In the case of product introduction, parental authority is actually *greater* when the local government is a partner than when the local unit is a wholly owned subsidiary. This suggests that the local government, which may be lacking in business expertise, defers to the company for these kinds of decisions.

In all other instances the local manager is likely to have more authority than if the enterprise were a wholly owned subsidiary, but less than would be the case if local interests controlled the company. Thus, governmental participation has a similar, but less pronounced, impact than local majority control. Inasmuch as the local governmental partner is not actively involved in business, corporations are somewhat less likely to cede authority to the local level than is the case with local private participation.

Contrasts in Decision Making and Impact on Local Control in Different Companies

Does the local manager's authority to make key decisions vary in different kinds of companies and organizations? And do these individual company categories respond differently to the challenge of local control?

Particularly for capital-expenditure decisions, there is considerable uniformity in the decision-making pattern and in the impact of local control for all of the various categories of companies that were examined. Except for product introduction, and labor and external relations, a substantial percentage of all of the companies insist on parental approval of key decisions. With the exception of product-introduction decisions, a large number of companies transfer a degree of authority to subsidiaries that are controlled by local interests.

Although there is a clear and consistent pattern of delegation to the local units for decision making, there are dissimilar approaches among companies with different types of organization, economic configuration, products, businesses (capital or labor intensive) and greater or lesser degrees of foreign sales.

Company Organization

In delegating authority to their local subsidiaries, product-line companies are more likely to insist on parental approval in the selection of a new head of local operations than are geographically organized firms. Evidently, the geographic companies are more likely to

consider themselves a federation of local companies and, as such, permit a more substantial degree of local participation in this decision. In a product-line organization, the new manager will become part of a worldwide network of product managers. How this individual fits into the organization is a matter of greater concern than how successfully the person can function in the local environment.

When local interests gain control of the subsidiary, product-line companies are more likely than their geographic counterparts to increase the local manager's authority for labor and external relations. This is an acknowledgment that, like it or not, the company has, to

a degree, become a local company. Even so, it is worth noting that this increase in authority comes in the two areas where local independence is already significant in most organizations.

One of the few instances where local control actually results in a *reduction* of the local manager's authority is product introduction in local units of geographic companies. In this instance, the company is putting on the brakes and saying that it will only go so far in the direction of becoming a local company. If the subsidiary is controlled by local interests, the company wants to exercise greater control over how its products are marketed (Table 11).

Table 11: General Delegation of Authority and Delegation When Local Interests Control—10 Key Decisions or Actions¹

<i>Comparison</i>	<i>General Approach to Delegation</i>	<i>Local Control</i>
Geographic and Product-Line Companies	Product-line companies retain more authority for top personnel decisions.	Product-line companies more likely to expand local managers' authority for labor and external relations. In geographic companies, local managers' authority for product introduction may be reduced.
Single and Multiproduct Businesses	Single-product companies are more likely to retain authority for product introduction.	Single-product more likely to expand authority of local managers for product introduction and labor relations. Multiproduct companies show greater reduction of parental authority to select new head of operations.
Consumer and Technology Producing Companies	Technology-producing companies give local manager more authority for political decisions. Consumer companies more likely to require consultation before entering new territory.	Technology-producing companies show expansion of parental authority for product introduction. Greater reduction of parental authority in consumer companies for establishing local research or development facilities.
Capital- and Labor-Intensive Companies	In labor-intensive companies local manager is more likely to have greater authority to establish research or development facility.	Capital-intensive companies are more likely to expand local managers' authority for product introduction. Labor-intensive companies are more likely to expand local managers' authority for political discussions.
Percentage of Foreign Business	Companies with more than 50 percent foreign business more likely to retain parental authority over local political issues.	As percentage of foreign business increases, retention of parental authority for capital expenditures is reduced. Middle group (33-49 percent foreign business) is more likely to continue to require parental approval to establish a research or development facility. As percentage of foreign business increases, the need for parental approval of a new head of local operations is less likely. But as percentage of foreign business increases, parental approval is more likely to be required for entering a new country.

¹Where a decision is not mentioned, there is no sizable difference in the pattern of delegation or in the degree of impact.

Economic Configuration

To a single-product company, control over how its product is marketed and sold is vastly more important than it is for multiproduct firms whose image and visibility is dependent on a variety of enterprises. This is confirmed by survey results; this kind of company retains greater control over product-introduction decisions when the subsidiary is wholly owned. When local interests gain control, a greater percentage of single-product companies yield some degree of authority to local units for this purpose. Single-product companies are also more affected by local control in the area of labor relations and, when this happens, they lose some control over the manufacturing process.

Local control has greater impact on multiproduct companies in only one area: the selection of a new head of local operations. It is possible that their more diversified portfolio makes this a concession that they are more willing to grant to the local unit.

The Nature of the Local Enterprise

In the wholly owned subsidiary, local managers of technology concerns are more likely to have greater authority than those in consumer enterprises for discussions of sensitive political issues. Among those interviewed, executives with companies that emphasize technology development commented that the local government was often the major, if not the only, customer. When discussing the sale of technology to a local government, it may be difficult in some cases to know where business ends and politics begins.

The greater delegation of authority to local managers for political discussions acknowledges this problem. If a local manager has a charter to do business for this kind of company, he may also need a certain amount of latitude to engage in talks of a politically sensitive nature.

When managing a wholly owned subsidiary of a consumer company, an individual is less likely to have authority to enter a new country than is the case with technology-oriented concerns. In this regard, the manufacturing process for technology is less likely to be confined by political boundaries. Component parts are manufactured in many countries and it is much more difficult to restrict a local manager's freedom of movement. In contrast, the assignment to head a local unit of a consumer company is more of a license to sell in a particular territory. This is especially true if the product can be manufactured locally and there are other units in adjacent countries.

When local interests gain control of a subsidiary, companies that stress technology actually increase the involvement of parent headquarters in product-introduction decisions. This shows a concern for the safeguarding of their patents, quality control, and a

careful review of their customers. It also suggests that local interests may desire, even demand, parental supervision of product introduction as a condition of doing business. Technological prowess may be the primary reason that the company is allowed to do business in the country.

Consumer companies exhibit a greater decline of parental authority in the establishment of research or development laboratories when faced with local financial control of a subsidiary. This is a concession more easily granted by consumer firms because of the importance of marketing as a lead activity and the local character of both products and markets. Because of these factors, research and development in this context is more often product testing and modification rather than basic research. In light of these circumstances, it may even be desirable to give the local unit more independence.

Capital- and Labor-Intensive Companies

When the subsidiary is wholly owned, the local manager of a labor-intensive unit is likely to have more authority to establish a research or development facility than is the case with capital-intensive companies. This is not surprising as the facility will, in all probability cost less, have a lower level of technology, and require a less technical skill from those employed. All in all, a smaller commitment does not require as much corporate oversight.

When faced with local control a larger number of capital-intensive companies are more likely to increase the local managers' authority for product introduction. As local interests assume a greater burden of the risk, these companies are willing to yield on product introduction. They may not have a great deal of choice; it is no longer just their money. Furthermore, they do not have the leverage that labor-intensive companies do in resisting local demands. Labor-intensive companies can mobilize a substantial local constituency—their own employees—to resist an unreasonable proposition. While this bargaining power probably has more effect on local governments than on investors, having a large work force does give them a bargaining point with their local partners.

For the same reason, labor-intensive firms are more likely than capital-intensive companies to increase the local managers' authority for political discussion when the subsidiary is controlled by local interests. The labor-intensive company knows that it has a strong bargaining position in dealing with the local government and it is less likely to be concerned about the local manager's ability to handle problems as they arise.

Percentage of Foreign Business

Apparently one of the awarenesses that comes with being a "world company" is the realization that political

issues are not isolated in their effect. Companies that do more than 50 percent of their business in foreign countries acknowledge this view and they are more likely to insist on parental approval for political negotiations when the subsidiary is wholly owned. They are also more likely to have an integrated corporate foreign policy than are the less international firms.

When faced with a subsidiary that is in local hands, companies with a high percentage of foreign business are more likely to yield to local participation in capital-expenditure decisions and in the choice of a new head of local operations. These are areas in which the impact of local majority participation is generally uniform. The greater impact on companies that do a larger percentage of their business in foreign countries suggests that these companies may have a more diversified portfolio and, therefore, see less risk in giving up some control in these areas. It may also be that their greater experience tells them that they can safely give more authority to the local unit.

By the same token, companies that do a larger percentage of their business in foreign countries when faced with local control are *less* likely than their counterparts to transfer decision-making authority to the local unit for entering new territories. A sense of the interdependence of events and circumstances prevails in the "world company," and parental involvement in these issues is likely for the same reason as is the case with political issues.

The middle group of companies (33-49 percent foreign business) is particularly affected by the issue of research and development facilities. When local investors gain control of their subsidiaries, they are more likely than either of the other two categories to continue to insist on parental approval for this kind of decision. This group is more likely than the other two to be involved with these issues. Their foreign activity is sufficiently limited so that they have yet to think in these terms, nor is it so large that they have made major commitments in response to these demands.

Chapter 5

Delegation of Authority to Local Managers of Foreign Subsidiaries

DELEGATION OF AUTHORITY involves the determination by the company of how much latitude managers will have to carry out the tasks assigned to them. If, for example, a business plan anticipates the sale of 100,000 widgets by a particular subsidiary, it is unlikely that any manager that the company will send to a particular location will have the same degree of discretion for accomplishing that objective. It is equally unlikely that the relative freedom that operations chiefs have in one local unit will follow them to another. To a certain extent authority is personal, but it is also derived from certain individual circumstances of time and place.

It is worth noting that delegation of authority is always limited. Seldom, if ever, do managers have the authority to *define* the job: The basic issue is how much leeway do they have to determine how it will be done?

Beyond this most important constraint there are other restrictions on the freedom to act. Every company imposes capital-spending limits on all of its subsidiaries. While these maxima vary considerably, no local operations head has unlimited authority for capital expenditures.

Operating expenses are usually less constrained. A number of interview participants noted that certain local managers, particularly in consumer companies, have vast discretion for advertising and promotion. Since these costs are viewed as recoverable, the manager has the pricing freedom to pass the expense along to the ultimate purchaser. This authority may be considerable as the company will consider the individual's experience and judgment—and the competitive environment in which the company is operating—in determining the extent to which it will defer to the managers' views.

While the most traditional and obvious limitation on local authority is the budgetary process, it is not the only one. Policy, which is the common law of the company, also plays a major role. In a large organization, everyone, even the CEO, is subject to the limits of policy—the

codification of the firm's institutional wisdom. Policy is not fixed and unchanging, but in every company there are core elements that often prove to be quite resistant to change and which make few, if any, concessions to particular individuals or circumstances.

Many constraints are self-imposed. Perhaps the most important ability with respect to the proper exercise of authority is knowing when and under what circumstances to use it. Effective managers are sparing in their use of power because their instincts tell them that what the corporate political process can grant it can also take away. Skillful managers use restraint even when they have authority to make a decision; in fact, they often owe much of their success to this.

Notwithstanding these limitations, a basic rule is that successful managers have more freedom and they use it in the way that works best for them. Where an operation, foreign or domestic, is not successful, it invites a good deal of corporate oversight.

When delegating authority to their foreign subsidiaries, companies use many of the same considerations as apply to the domestic ones, but they also pay a good deal of attention to other factors (Table 12).

Size is the most important of these criteria in determining a local manager's independence. Some executives noted that market share is even more important than the size of a particular unit. A high market share enhances a manager's bargaining power in dealing with local interests and, from the company's point of view, it is a sign that the manager is performing well compared with his or her colleagues in other countries.

Sometimes the local manager's autonomy is derived from the individual's unique knowledge and ability to manage a particular local operation. One company cited the president of its Japanese subsidiary in this regard. This individual's ability to understand and manage the intricacies of local commercial relationships gives him enormous power in dealing with the parent company.

Table 12: Factors Resulting in a High Degree of Decision-Making Authority for Local Managers (109 Companies)

<i>Condition</i>	<i>Results in High Level of Authority Number of Companies¹</i>
Bargaining Power of Local Unit	
Local Unit is Relatively Large.	63
Confidence in Local Manager	
High Rank within Organization	59
Local manager has spent considerable time in other units in other countries	46
Local manager has spent considerable time in parent company headquarters.	42
Ongoing Negotiating Process or Shared Values	
Company has been active in country for a long time	53
Subsidiary is in an industrially developed country.	37
Long business history between country of parent and country of subsidiary	36
Close geographic or cultural ties between country of parent and country of subsidiary	27
Proprietary and Cultural Factors	
Local Interests are majority shareholders	31
Local unit is a branch or wholly owned subsidiary.	27
Manager of local unit is a local national	23
Manager of local unit is the same nationality as parent company	20
Local interests are minority shareholders	18
Local government is a participant in the enterprise.	16

¹Multiple responses were permitted.

They are quite likely to defer to his judgement on many questions.

Companies also value the existence of an ongoing negotiating relationship and shared values and objectives between their organization and the countries in which they do business. Where orderly procedures exist for the airing of grievances, and where there are a common vocabulary and well-defined local objectives to which the company can respond, the local manager is likely to have more power in discussions with local interests. It is also

helpful in this regard if the spokesmen for local groups really do represent important constituencies and can give full force and effect to any agreement reached by the parties.¹

Evidence of the importance of these factors can be seen in the significance attached by many companies to long-standing company experience within the country; the existence of business, cultural or geographic ties between the country of the parent and the country in which the unit is located, and whether the subsidiary is in an industrially developed country.

The financial participation of local interests (in some cases this includes the government), though less important in determining local independence, does have an impact in many companies. This is particularly true when local interests have a controlling position. But companies will develop approaches in order to listen to and respond to local concerns even when they do not have a controlling position and formal authority has not been delegated to the local unit.

Commenting on this point, the corporate secretary of one of the world's largest multinationals noted: "The most delicate cases are those where you are in a majority, let us say you have 60 percent. You have to be especially careful in situations of this kind. You can't just run over these local people because you have control."

This admonition is especially valid when the financial participant is the local government. Just over one-third of the participants (37) reported at least one situation of this type among their foreign subsidiaries, and these circumstances can also be a factor in the delegation of authority to the local unit.

Just exactly how a government business partner affects the independence of the local unit depends, in significant measure, on the government's objectives in entering into the arrangement. If the motive in participating is to obtain a hearing for its views before the top management of a distant multinational, the result may be a greater involvement of corporate headquarters in the activities of the local unit than might otherwise be the case. Where the government has the objective of being involved in the creation of a locally successful business, its role in the venture may promote the independence of the local manager.

Finally, the company's confidence in the experience and ability of the local manager is also important. The single, all-embracing evidence of this confidence is the individual's rank within the company, and this can be a significant predictor of the local manager's authority. Still, high rank does not universally confer substantial authority and other factors are considered as—and, in some cases, more—important.

¹Allen R. Jangur and Ronald E. Berenbeim, 1981.

Experience, both in company headquarters, and in local units in other countries, is less valued, but also important. There is a tendency for technology-producing firms to put a higher premium on headquarters experience and for consumer operations to attach more importance to time spent in local units.

Important Considerations in Delegation of Authority

Table 12 shows the criteria deemed most important by the respondents in granting substantial freedom in decision making to managers of local subsidiaries. Among the participants in the survey, the size of the unit was the single, all-embracing criterion of autonomy. Big units are most likely to be well-established businesses with high-ranking, experienced local managers, and these factors are also considered highly important. Although small branches may also have been active in the country for a long time and may also have seasoned local heads, this is not as certain to be the case as is true with large subsidiaries.

In addition, the larger organizations often have their own staffs. An executive with one of the world's largest food companies put it this way: "Large units have more resources for independent decision making. They often have their own development groups and marketing organizations. For this reason, they are likely to have greater independence as long as their results are good."

Relevant knowledge and degree of risk also play roles. An individual with a high-technology company expressed this view: "It is a question of materiality. The chap in Nigeria has plenty of authority. It is a small operation and he knows more about what is going on in Nigeria than anyone in headquarters. We will not be badly hurt if he makes a mistake. If the man in Germany does the wrong thing, we could get killed. He has to consult with the parent company more often."

Another component of local authority is whether the subsidiary is in an industrially developed country. For the 37 companies that give their managers more authority in this situation, industrial development contributes to the existence of a negotiating process and to shared values. The more stable political systems and the greater governmental procedural regularity that are often an outgrowth of industrial development provide the mechanisms for negotiation, and industrialization helps to define mutual objectives.

Still, it does not always work that way. Participants expressed considerable concern with problems in two advanced industrial countries (France and Canada) and even the United States was not immune to this type of discontent. Seven companies said that their managers in advanced industrial countries actually have *less* authority than their opposite numbers in other subsidiaries, and thirty-two said that the level of industrialization was an

important consideration but, depending on the circumstances, it could result in a high or low level of authority.

It would appear that industrialization reduces certain kinds of political risks—such as expropriation—which are paramount concerns. For others, however, the economic problems of doing business in an advanced economy (competition, regulation and labor demands) may weigh more heavily. For a third group (roughly one-third of the sample), whether or not the country is industrialized raises issues that must be resolved in accordance with individual circumstances.

Proprietary and Cultural Issues

While the study participants regarded local ownership and the nationality of local managers as important determinants of decision-making authority, other factors also played a role.

Survey participants rated local majority control as comparable to unit size and the rank of the local manager as significant factors in determining the authority of local operating chiefs. The companies, however, were not entirely of one mind as to what should be done about it. Only 31 companies said that this situation automatically results in greater authority for the local manager; 21 noted that it usually leads to less authority.

Where local participation takes the form of a minority interest, the largest number of companies reported that this tends to result in a low level of authority for the local manager. This echoes the view expressed earlier that where there is substantial local participation, you have to be careful. Although this situation affords parent companies wide latitude to do as they please, the largest number of them are included to be cautious in the authority they give the local manager.

As stated earlier, when local interests have majority participation the local manager's hand appears to be stronger than is the case with his or her counterparts in branches, divisions and wholly owned subsidiaries in his dealings with the corporate office. In this instance, the largest number of respondents said that this situation resulted in a high level of authority. An interviewee stated the reason why this is often the case: "Under those conditions the subsidiary is like a local company, and the local chief of operations deals with the parent as the head of that local company."

Where local government is a participant, there is almost a dead heat among the three major responses. Relatively few companies are in partnership with a local government in more than one region (the median among those that responded was between one and two subsidiaries). Thus, the approach depends on individual circumstances.

It is clear from the responses that companies are evenly divided as to the best way to handle this situation. Some

of them give the local manager a high degree of authority for much the same reasons that many organizations grant substantial latitude to the local head where local interests are in a majority. Others apparently feel that it makes more sense to deal with their local partners directly from corporate headquarters.

Of all the different local conditions examined, the impact of the local manager's nationality on the individual's authority produced the most equivocal responses. For only slightly less than one-third of the companies, nationality in itself is an important criterion. Among this group, roughly two-thirds in each case give the local manager more authority when the person's nationality is the same as the parent corporation, or when the individual is a local national.

Delegation of Authority by Country

The respondents were asked to indicate on a scale of one to five, with five being the highest, the relative decision-making autonomy of their local managers in each of fifteen countries (Table 13). (If the country was not foreign for them they did not answer that particular question.)

The results are consistent with the earlier findings with respect to the importance of the various factors examined with special emphasis in this instance on the existing ongoing negotiating process. As there is no way that this particular set of questions can measure confidence in the local manager, confidence in this context relates to the country's political, economic and social stability. With regard to this question, it appears that companies do not make hard and fast distinctions between industrially developed and less-developed countries but choose instead to look at the *level* of development. In addition, the size of the company's potential market is also quite important. Thus, the Netherlands, a small, highly industrialized country, gets the same rating as Brazil, a large country with moderate level of industry.

For the most part, the kind of local demands discussed

Table 13: Degree of Autonomy of Local Managers in Foreign Countries (Rated 1-5, 5 is the highest; 109 companies)

<i>Country</i>	<i>Median Score</i>
United States	4 +
Canada	4
Great Britain	4
France	3
Netherlands	3
Germany	3
Spain	3
Japan	3
Australia	3
Mexico	3
Brazil	3
Argentina	3
Saudi Arabia	2
Nigeria	2
Indonesia	2

earlier do not adversely affect the local manager's authority. (Among those interviewed, some suggested that difficult local conditions may even *increase* the autonomy of the local operations head.) Canada, for example, is a country that arouses increasing concern among those surveyed because of its demands for research facilities and for top-management positions for local nationals, yet a local manager in Canada is likely to have more authority than a regional head in Germany, a country that was rarely mentioned as imposing local restrictions.

Above all, the country responses illustrate the importance of well-understood mechanisms and procedures for dispute resolution in granting local autonomy. Those countries receiving the highest ratings are likely to be the areas in which the respondents have been active for a long period of time and are the beneficiaries of long-standing cultural or commercial ties between the country of the parent and the country of the local unit.

Appendix

Local Demands: Which Countries

Among the countries most often mentioned as making the most frequent demands, Brazil, Mexico and India received by far the greatest number of mentions. (See Table A-1.) Brazil is among the top five countries for seven of the nine demands examined. Brazil leads in the imposition of four conditions:

- (1) restriction on research charges,
- (2) limits on repatriation of assets,
- (3) requirement of local purchase of components or raw materials, and
- (4) requirement of production or sale of certain products.

Mexico is first among the countries making demands for local financial participation. It is in the top five countries in eight of the nine categories—all but the demand for the appointment of local nationals to top-management positions.

India is ranked first among those countries demanding local research facilities and those that limit production levels. It is in the top five countries in all nine categories.

The frequent mention of these countries is, of course, not only a measure of demands. It is also a testimony to the large number of companies in the survey that do business in these regions. To some extent it also reflects their continued profitability: Only eleven companies (10 percent) have said that these restrictions resulted in their not doing business in India. In the case of Brazil and Mexico, the number was far smaller—six and five, respectively. Thirteen of the twenty-two refusals were occasioned by two of the requirements; demand for local financial participation (six), and limit on repatriation of assets (7).

For the most part, participants do not feel that Brazil, Mexico and India will make any particular demands more frequently in the next ten years than they have in the past decade (Table A-2). This was especially true of India, where only 12 respondents expected more problems in the next ten years. (This was in marked contrast to the 24 that are concerned with conditions in France.) More expected

Brazil (35) and Mexico (42) to increase their demands in the future. All but a handful anticipate that their problems in Brazil, Mexico and India will come in one of four areas: demand for local financial participation (29); requirement of local purchase of raw materials and component parts (18); restriction on research charges (13); and limit on repatriation of assets (11).

Countries to Watch

Although the importance of Brazil, Mexico and India in this regard could, perhaps, have been anticipated, three more advanced industrial countries, Spain, France and Canada were also frequently mentioned. Canada led among those countries requiring the appointment of local nationals to top-management positions, while France was first among the countries that limit the share of local markets.

With respect to expectation of future demands, a large number foresee future problems in France, particularly in the area of local financial participation. It is possible that much of the apprehension in the case of France is due to its Socialist government. At the time of the survey, however, Spain had not yet elected a Socialist prime minister, and the large number of demands that had occurred in the past took place when Spain was governed by a center-right coalition. The frequent mention of these three countries shows that these problems can occur in areas where industrialization is relatively advanced.

Countries of Special Interest

Regardless of the number of incidents reported in doing business within their borders, three countries, Japan, the United States, and China are of special interest. Of these, Japan has, by far, proven to be the greatest problem. It received nineteen mentions and placed in the top five countries in two out of nine categories: (1) demand for local financial participation, and (2) requiring local nationals to be appointed to top-management positions.

Table A-1: Countries that Make Frequent Local Demands (10 or more Episodes)

Country	Demand							Produce or Sell Certain Products as Condition of Entry	Total
	Financial Participation	Top- Management Positions	R&D Facility	Restriction on Charges for Research	Limit Repatriation of Assets or Earnings	Local Purchase of Raw Materials Component Parts	Limit Production		
Brazil	10	1	7	23 ^a	26 ^a	32 ^a	2	5 ^a	108
Mexico	30 ^a	2	7	10	8	26	3	4	93
India	21	5	12 ^a	11	8	8	8 ^a	3	80
Spain	6	2	5	9	7	8	—	4	42
Indonesia	18	3	3	2	—	2	—	3	35
Nigeria	20	7	—	2	3	—	—	4	34
France	1	3	9	5	1	2	3	2	32
Canada	6	7 ^a	9	1	—	5	1	1	30
Venezuela	5	1	1	9	6	5	—	—	27
Argentina	4	—	—	6	7	9	—	—	26
Malaysia	6	7 ^a	9	1	—	5	1	1	30
Colombia	6	—	—	7	4	—	1	—	19
Japan	10	4	3	—	—	1	—	1	19
Saudi Arabia	9	4	1	1	—	—	—	—	14
Turkey	—	—	1	2	5	3	1	3	15
Peru	9	2	—	1	1	1	—	—	14
Iran	6	2	—	—	2	—	1	1	12

^aHighest number of reported incidents for this category; full description of categories in text, pp.13-14.

Table A-2: Countries in Which Demands Are Expected to Become More Frequent in the Next 10 Years (7 or more Responses)

Country	Demand							Produce or Sell Certain Products as Condition of Entry	Total
	Financial Participation	Top- Management Positions	R&D Facility	Restriction on Charges for Research	Limit Repatriation of Assets or Earnings	Local Purchase of Raw Materials Component Parts	Limit Production		
Mexico	14	—	2	6	7	9	1	1	42
Brazil	11	2	4	5	3	9	—	1	35
France	8	2	3	4	—	2	2	1	24
Indonesia	6	4	—	1	—	3	1	1	18
Canada	2	2	6	—	—	1	—	1	12
India	4	2	—	2	1	—	2	—	12
Spain	4	2	1	2	—	2	1	1	12
Venezuela	4	—	1	3	—	1	—	—	9
Japan	2	2	2	—	—	1	—	1	8
Malaysia	3	3	1	—	—	—	—	—	7

European firms reported seven episodes of difficulty in the United States. These occurred in the areas of financial participation, appointment of top managers, research facilities, restriction on research charges, and local purchase of component parts or raw materials.

Limited involvement in China by companies in the sample produced only four responses for that country.

As to expectations for the future, Japan and China aroused moderate concern. The United States is not expected to be a problem in that regard, with only three mentions.

Regional Characteristics

One region of the world, Latin America, was more conspicuous than any other in advancing these demands. Latin American countries account for nearly half the countries ranked in the top five in each of the nine categories. As already noted, Brazil and Mexico are especially prominent. Argentina, Venezuela, Columbia and Peru, however, are also mentioned frequently.

Latin America's prominence is due to the presence of a critical mass as to the level of industrialization, labor skills, and consumer markets. Once this level is reached, Latin American governments perceive that the national interest can be advanced by imposing these conditions. If the state's power is great, as is often the case in this region, it will not encounter local resistance in implementing its strategy. If doing business in the country is profitable, it has the negotiating leverage to impose its demands on the company. This suggests that some countries like Indonesia and Nigeria (which the survey participants ranked fifth and sixth, respectively) may make demands on the same scale as Brazil and Mexico when, and if, their economies reach a comparable stage of development.

Those areas of local control that are of little or no concern to Latin American countries are also of interest. No Latin American country ranks among the top five that demand the appointment of local nationals to top management positions, and only Mexico (which ranks fourth) is included in the top group of countries that limit the share of local markets. Latin American countries do figure prominently among those that demand financial participation for local interests, restrict research charges, limit repatriation of assets, and require local purchase of components or raw materials.

This emphasis suggests that the Latin American countries focus primarily on investment issues. They want a share of the profits and they want companies that do business in their countries to reinvest the proceeds locally. They are less interested in symbolic issues such as the appointment of locals to top-management positions. This may be true for two reasons. First, to a substantial degree this objective may already have been achieved.¹ Second, it is of no value in generating local investment and in protecting important national resources.

The second conspicuous regional generalization is the small number of mentions of oil-producing countries among those that limit production levels. Saudi Arabia and Libya received only one mention each in this category, while three respondents noted that Mexico has been a problem. Three of the countries in the top group that limit production, India, France and Pakistan, are not abundantly rich in natural resources. Thus the motivation for imposing this condition may well be the desire to regulate local competition, rather than concern over the exploitation of natural resources.

¹Ronald E. Berenbeim, 1981.

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